USE OF COMMERCIAL POLICIES FOR PURPOSES OF ECONOMIC DEVELOPMENT WITH RESPECT TO SELECTED UNDERDEVELOPED COUNTRIES

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CHAPTER I

INTRODUCTION

PURPOSE OF STUDY

The purpose of this study is to investigate the effectiveness and the effects of commercial policy employed by underdeveloped countries for promoting economic development. It is assumed that the economic objective assigned first priority by underdeveloped countries is development, or economic growth, rather than most efficient allocation of existing resources.[1]

Based on this assumption, the analysis has a two-fold emphasis. First is emphasis on the potentialities of unifying commercial policy decisions toward the predominant objective, development. This is in contrast to the tendency for commercial policy decisions to be made in pursuit of a variety of often conflicting objectives that are adopted out of expediency during possibly severe but often temporary crises such as a sudden worsening of the terms of trade or decline in foreign exchange balances. The second emphasis is on the relative effectiveness of the particular commercial policy devices--tariffs and foreign trade subsidies, quotas, and exchange controls--in promoting economic development.

The literature on underdeveloped countries contains discussions of elements of both of these points of emphasis, but we know of no overall treatment of the two together. The analyses of particular commercial policy devices have concentrated on one or another of the three principal commercial policy instruments, with most recent attentions paid to exchange

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1 For a discussion of the reasons and basis for this assumption, see p. 25 below.

controls,[2] rather than a systematic comparison of their relative effectiveness and possible co-ordination in a commercial policy system for promoting development. Discussions of the general uses of commercial policy for development have tended to concentrate on appropriate objectives in terms of development needs[3] rather than on the suitability of specific commercial policy instruments for assisting in the fulfillment of those objectives.

Economic development is here taken to mean a sustained increase in real national income per capita. This definition, basically, is common in the literature on underdeveloped countries despite recognized difficulties of precise formulation for statistical measurement[4] and despite the fact that it ignores some important welfare considerations.[5] Taken into account in the definition are changes in populations and price levels, while ignored is the nature of the distribution of income.

High population growth potentials in most of the underdeveloped countries are threatening to counteract any benefits to be derived from efforts

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2 Cf. E. R. Schlesinger, Multiple Exchange Rates and Economic Development, International Finance Section, Princeton University Press, 1952; United Nations, "The Application of Multiple Exchange Rates in Selected Asian Countries," Economic Bulletin for Asia and the Far East, Vol. V, No. 3, November, 1954, pp. 19-38.

3 Cf. G. Myrdal, An International Economy, Harper & Brothers, New York, 1956, chap. XIII; United Nations, "Trade Policy as a Means of Implementing or Promoting Economic Development, with Special Reference to ECAFE Countries" (prepared by the GATT Secretariat), Economic Bulletin for Asia and the Far East, Vol. VIII, No. 1, May, 1957, pp. 8-17; C. P. Kindleberger. Economic Development, McGraw-Hill Book Co., Inc., New York, 1958, chap. 14.

4 See S. Kuznets, "Measurement of Economic Growth", Problems in the Study of Economic Growth, National Bureau of Economic Research, New York, 1949, pp. 137-172.

5 See, especially, J. Viner, International Trade and Economic Development, The Free Press, Glencoe, Ill., 1952, pp. 120-129; also, N. S. Buchanan and H. S. Ellis, Approaches to Economic Development, The Twentieth Century Fund, New York, 1955, chap. 1; G. M. Meier and R. E. Baldwin, Economic Development: Theory, History, Policy, John Wiley & Sons, Inc., New York, 1957, pp. 2-10; Kindleberger, op. cit., pp. 1-10.

at economic development that result in increases in aggregate income. This fact lends a greater sense of urgency in these countries to achievement of a high rate of economic growth. Although no judgment is made in this study as to what would constitute a desirable distribution of income, it may be an important determinant of whether or not growth can be maintained. Furthermore, it is presumed that some concern for widening the distribution of the benefits of development in underdeveloped countries is a political necessity for retention of power even in a totalitarian state. It is possible, however, that the necessary spread of benefits varies more or less inversely with the centralization of political power.[6]

The precise lines of demarcation as between developed and underdeveloped countries are arbitrary regardless of what criteria are used as a basis for classification. It is not, however, essential for purposes of this study that a precise line of demarcation be drawn. Many of the distinguishing characteristics of underdeveloped economies also characterize economies of countries near the dividing line but on the "developed" side in any classification based on a single criterion such as income per capita. Consequently, the observed effects of commercial policy actions in marginal countries on either side of a line of demarcation are likely to be as relevant for the analysis of this study as effects in cases drawn from countries that can be more clearly classed as underdeveloped.

It may suffice, therefore, merely to note some distinctive aspects generally recognized to characterize so-called underdeveloped economies. The

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6 Kindleberger suggests that more equal distribution of income may occur with development. Ibid., p. 8. See also S. Kuznets, "Economic Growth and Income Inequality", American Economic Review, March, 1955, pp. 1-28.

countries that would be classified as underdeveloped on the basis of any criteria vary in the degree to which such aspects characterize each, yet most of such characteristics apply broadly to each of such countries. In relation to the problems of economic development, important conditions distinguishing underdeveloped countries are social and political in nature as well as economic.

Economically, underdeveloped countries are marked not only by low incomes per capita and extremely unequal distributions of income,[7] but also by low ratios of capital to labor and capital to land.[8] Labor tends to be heavily concentrated in primary production, i. e., extractive industries, especially in subsistence and/or export agriculture.[9] Transportation and communication facilities are meager and inefficient by developed-country standards.[10] All of these conditions contribute to inadequacies in the development of the exchange economy in terms of small, inefficient and fragmented markets.[11] Of significance in this regard is the lack of well organized money markets with financial institutions and arrangements primarily confined to larger urban areas and related to foreign trading relations.[12]

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7 See T. Morgan, "Distribution of Income in Ceylon, Puerto Rico, the United States and the United Kingdom," Economic Journal, December, 1953, pp. 821-834; S. Kuznets, "Economic Growth and Income Inequality," American Economic Review, March, 1955, pp. 1-28.

8 Data indicating these ratios are largely indirect as well as limited in extent, yet the data available, e. g., energy consumed per capita, railroad mileage per area unit, etc., indicate tremendous differences between developed and underdeveloped countries. See Buchanan and Ellis, op. cit., pp. 461-463 (t); Colin Clark, The Conditions of Economic Progress, Macmillan & Co., Ltd., London, 1951, pp. 486-489 (t).

9 See W. S. and E. S. Woytinsky, World Population and Production, The Twentieth Century Fund, New York, 1953, pp. 356-7 (t).

10 Buchanan and Ellis, op. cit., pp. 461-463 (t).

11 M. R. Solomon, "The Structure of the Market in Undeveloped Economies," The Quarterly Journal of Economics, August, 1948, pp. 519-537.

12 Ibid., p. 536. See also United Nations, "Mobilization of Domestic

Social conditions and population characteristics in underdeveloped countries make for inertia and, in some areas, even outright resistance to change. Illiteracy percentages are high and health standards are low,[13] which means uneducated, untrained and debilitated populations. Furthermore, the population majorities in most underdeveloped countries live in rural areas or small villages[14] where social patterns tend to be family or kinship oriented. Under such conditions, behavior is largely habitual and rooted in tradition. Finally, there is on the part of those individuals or groups in underdeveloped countries who suffer the greatest poverty, privation and ignorance a tendency toward fatalistic acceptance of their lot.[15]

In the political situation of underdeveloped countries, factors which make for political instability are of particular significance for development. This potential instability stems from certain cleavages regarding understanding and aspirations as between various oppositional groups.[16] In effect, the leaders and the educated of the underdeveloped

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Resources for Economic Development and the Financial Institutions in the ECAFE Region," Economic Bulletin for Asia and the Far East, Vol. 1, August 1950, p. 28; R. Triffin, "Central Banking and Monetary Management in Latin America," Economic Problems of Latin America (S. E. Harris, ed.), McGraw-Hill Book Co., Inc., New York, 1944, p. 104.

13 See Meier and Baldwin, op. cit., p. 296 (t).

14 See Woytinsky and Woytinsky, op. cit., pp. 114-118.

15 For discussions of these and other social aspects in underdeveloped countries, see H. Belshaw, "Some Social Aspects of Economic Development in Under-developed Countries in Asia," Underdeveloped Areas (L. W. Shannon, ed.), Harper & Brothers, New York, 1957, pp. 190-194. (Reprinted from Civilizations, Vol. 4, No. 4, 1954.) Also, R. Linton, "Cultural and Personality Factors Affecting Economic Growth," The Progress of Underdeveloped Areas, B. F. Hoselitz, ed., University of Chicago Press, Chicago, 1952, pp. 73-88.

16 Suggested by James S. Coleman in a joint political science and economics seminar at Coe College during the spring semester of 1959.

countries live in a different world from the mass of their fellow citizens, yet in proximity. In many cases, lack of understanding and common cause result in doubt and mistrust even in those countries with a relatively greater degree of political democracy. This situation threatens the viability of the democratic regimes, as well as the more totalitarian, in the face of both internal and external pressures.

The aspirations--both for their country and for themselves--of the educated, especially the young, newly educated, differ from those of the mass of illiterate and uneducated. The leaders and the better educated have been more susceptible to the influence of the "demonstration effect." The divergency of aspirations tends to be reinforced by a cleavage between those in the urban centers who have been more thoroughly caught up in the exchange economy and those in the rural areas whose productive activities are still largely subsistence oriented.

A further notable cleavage exists between those who have developed a more secularist attitude involving a readier acceptance of change and those who have retained a more traditionalist attitude that means greater resistance to change. Finally, the extreme inequality in the distribution of income noted above represents another group cleavage with significance for political stability. Those with great wealth tend to oppose policies or changes that are likely to undermine their favored position, while even those tradition-oriented who are also poverty stricken tend to give tacit support to changes in the locus of political power promulgated by almost any disgruntled faction so long as the pattern of their lives is not directly or immediately disrupted.

The opposing interests represented by the cleavages noted are not

concurrent in a fixed pattern. While there is, in underdeveloped countries as in most societies, a tendency for the leaders to come from the educated, for the educated to come from the relatively wealthy, for the relatively wealthy to be urbanized and even cosmopolitan, and for the secularists to be found among the educated and urbanized, these categories are not concurrent. This situation makes for many cross-currents of interest. The cleavages noted tend to be more pronounced in underdeveloped countries than in advanced countries and marked by a greater inequality in the division of the population as between those extremely small categories just listed and the extremely large categories of uneducated, poor, rural and traditionalist.

The element of primary political significance that derives from this situation is the failure of the bulk of the population in underdeveloped countries to be directly involved in the political process,[17] so that they are more easily swayed by emotional appeals for their allegiance when improvement in their lot is slow or non-existent. This increases the possibility of sudden changes in political control through political coups.

Taken together, the political conditions described are one factor that makes dramatic economic development with some broader spread of benefits imperative from the point of view both of the underdeveloped countries and of the rest of the world, especially the West. In this political context, the economic and social factors noted, which militate

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17 See E. Staley, The Future of Underdeveloped Countries, Council on Foreign Relations (Harper & Brothers), New York, 1954, pp. 222-227.

against private, individual initiative in the economic sphere, lend importance to this investigation of the commercial policy potential in assisting the process of development. The problem is so pressing that underdeveloped countries cannot afford to fail to consider any approach which contains possibilities of furthering development.

SCOPE AND METHOD

In view of the conditions described in the preceding section, the analysis in this study has been carried forward on the basis of certain assumptions that differ from the usual assumptions on which analysis of international trading relations ordinarily has been based. First, it is assumed that the governments of the underdeveloped countries will have to, and will, play an active role in the economy both to initiate productive enterprises on its own, especially of the social-overhead-capital nature, and to stimulate private enterprise directly and indirectly by creating a favorable climate in which individual initiative can become much more effective than it has been in the past. Second, the conditions of perfect competition which have been deemed necessary for the efficient operation of market systems, are inadequate as to refinements and extent for the efficient allocation of resources, especially as between production for present consumption and for capital formation. The third assumption is that the predominant economic objective of governments in underdeveloped countries is development, involving particularly a change in the quality and quantity of resources such that the productivity of human effort is raised. A corollary of this third assumption is that the economic objective of most efficient allocation of resources must be oriented around structural change. Finally, it is assumed that the

economic factors usually taken as given, i. e., the "parameters" of the economy--technology, productive functions, and the pattern of resources--are susceptible to deliberate modification in a relatively short period of time, say a generation. These assumptions are not designed to supercede our inherited body of theoretical tools, but rather to indicate necessary modification in the use of those tools, especially in an analysis of commercial policy decisions in underdeveloped countries.

In large measure, Chapter II constitutes a justification of the adoption of these assumptions by way of an analysis of the inappropriateness of the traditional model of international trade theory as a basis for evaluating commercial policy objectives and measures of underdeveloped countries. First the implicit and explicit assumptions of traditional international trade theory are outlined, and the functioning of the international economy that they imply is described. The significance of this theory as a basis for free trade policy recommendations is pointed out. The relevance of the traditional theoretical model and its resultant free trade policy recommendations as they apply to underdeveloped countries is then subjected to a detailed criticism.

On the basis of this analysis, it is concluded that the peculiar circumstances of underdeveloped countries and the problems associated with originating economic development in these countries make inappropriate the application of traditional international trade theory to underdeveloped countries. It is further concluded that adoption of a free trade policy by underdeveloped countries would tend to perpetuate their underdeveloped status, and therefore, that commercial policy controls on foreign trading relations can assist them in their efforts to develop economically.

The primary purpose in Chapter II is to indicate, in a preliminary fashion, the manner in which commercial policies of underdeveloped countries may be formulated with development needs and objectives always given top priority in the policy decisions. This approach is in contrast to the usual practice in the past of formulating commercial policies on a piecemeal and expedient basis in pursuit of dissimilar and sometimes conflicting objectives without a unity of purpose and direction. To this end, the nature of the commercial policy instruments and their variants, that are treated in this study, is first presented with the purpose of summarizing this information and of delimiting the scope of this study.

There follows a statement of the importance of foreign trade to underdeveloped countries in their efforts to develop. The principal point is that the use of commercial policy for development does not necessarily mean withdrawal from the international economy as seems often implied in the tendency to state the trade control question in terms of an either / or choice of trade versus no trade. Specific development objectives and needs of underdeveloped countries are then itemized in a brief but systematic form, after which particular commercial policy objectives that may be adopted in furtherance of fulfillment of various development needs are presented. This discussion is designed to facilitate the more detailed analysis of particular commercial policy devices in Chapter IV.

Chapter IV is devoted to a theoretical analysis of the best choices of commercial policy instruments for achievement of particular development needs and objectives as well as the possibilities of coordinating the use of the commercial policy instruments toward the predominant economic ob-

jective of development. Tariff, quantitative control and exchange control systems are capable of being structured in a virtually infinite variety of combinations of detailed provisions. In addition, the detailed variants of the three main commercial policy weapons are for some purposes interchangeable with varying degrees of efficiency.

With these points in mind, the analysis in Chapter IV is an attempt to answer the question: Which commercial policy variants are most appropriate for fulfilling which commercial policy objectives that are in turn selected for their contribution to fulfillment of development needs and objectives? As indicated, this is a theoretical analysis based on the assumptions listed at the beginning of this section with little reference to actual commercial policy provisions adopted in any particular country.

Chapter V is devoted to an empirical investigation of actual commercial policy provisions in the various underdeveloped countries. It is designed to check the validity of the theoretical analysis of the preceding chapter.

The investigative procedure was to compile as complete information regarding actual commercial policy actions of underdeveloped countries as available data would permit. For this compilation, primary reliance has been on the U. S. Department of Commerce, World Trade Information Service, Operations Reports on tariff, quantity licensing and exchange control systems of the various countries of the world, and the Foreign Commerce Weekly news of trade control changes, supplemented by reports of the International Monetary Fund.

From this information on the various underdeveloped countries, cases

of actual use of commercial policy devices for furthering development, as suggested in Chapter IV, have been selected for evaluation as to the effects of the commercial policy actions. The evaluation has been in terms of the resultant changes in foreign exchange and gold balances, the composition of imports and exports, balances of payments, terms of trade, government revenues by sources, real- and money-capital movements, and in the aggregates of quantity and value of imports and exports, total national income and national income or product per capita, production by sectors, foreign and domestic investment, savings and consumption.

In Chapter VI, tentative conclusions are drawn in light of the preceding analysis as to the place of commercial policies in the over-all development programs of underdeveloped countries, and the prospects of their use in the future.

CHAPTER II

INTERNATIONAL TRADE THEORY AND UNDERDEVELOPED COUNTRIES

The conclusions of a theory are conditioned by the assumptions of the theory.[1] The assumptions of traditional international trade theory have led to conclusions and commercial policy recommendations that are inappropriate for underdeveloped countries that are attempting to develop.

It is the purpose of this chapter to demonstrate the validity of the foregoing assertion and to indicate the conditions in underdeveloped countries within which commercial policy decisions for furthering development must be made. The assumptions of traditional international trade theory are detailed, as well as the economic system which those assumptions imply. The assumptions are then criticized in relation to the conditions in underdeveloped countries, and the commercial policy implications of that criticism are made explicit.

What, then, is the analytical framework of traditional international trade theory and its relevance for commercial policies of underdeveloped countries?

THE FRAME OF REFERENCE OF INTERNATIONAL TRADE THEORY

International trade theory, from Classical to modern, has developed within a framework of both implicit and explicit assumptions as to the basic nature and environment of economic activity.[2] The traditional in-

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1 See Oscar Lange, "The Scope and Method of Economics", Review of Economic Studies, 1945-1946, p. 21.

2 An excellent resume of the development of international trade theory from Classical to modern is presented by P. T. Ellsworth in his The International Economy (1950), Chap. 5. This discussion includes a statement of assumptions which underlie the general equilibrium of international

ternational trade theory model has been the same as that for general value theory except for particular assumptions based on peculiarities of international exchange as opposed to exchange of goods and services in a domestic economy.[3] In general terms, that theoretical model has depicted economic activity as being individualistic and without interference either from government or from other private individuals or groups exercising monopolistic power. In other words, the assumption has been that international exchange of commodities occurs between private individuals and businesses of different countries operating in an atmosphere of "free private competitive enterprise."

This general economic framework and the specific assumptions which it involves were conceived by Western economists in reference to Western economies. The result is a conceptual frame of reference---social, political and economic---which does not fit underdeveloped economies as we know of them today.

The Specific Assumptions and the Economic System Implied

General Value Theory Assumptions. The assumptions which set the pattern of economic activity as conceived in economic theory are:[4]

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trade developed by Bertil Ohlin in Interregional and International Trade (1933) which is an extension of modern value theory. Ellsworth's discussion in the latest edition of his book (1958) is somewhat less systematic, but carries the analysis of modern theory further, including a discussion of the most significant recent development of Romney Robinson regarding the effects of varying factor proportions in "Factor Proportions and Comparative Advantage," Quarterly Journal of Economics, LXX, May and August, 1956. For a more detailed discussion of recent developments in international trade theory up to 1948, see Lloyd A. Metzler, "The Theory of International Trade", A Survey of Contemporary Economics, Vol. I, 1948.

3 Ellsworth, op. cit., p. 120.

4 The assumptions listed first are those which are applicable to eco-

(1) the exchange of products and factors of production on a purely private-capitalist enterprise basis; (2) no government interference; (3) no private-monopolistic interference; (4) economically rational behavior, i. e., each individual and enterprise attempting to maximize satisfaction (or profit) from the use of his (its) resources; and (5) a perfectly, or nearly perfectly, competitive market for each product and factor of production. By definition, competitve markets require: (a) a large enough number of buyers and sellers of each product and factor of production that no one of them by his actions can affect the exchange price; (b) perfect, or nearly perfect, knowledge of market conditions; and (c) perfect, or nearly perfect, mobility of enterprises and factors of production.[5]

It follows logically from these assumed conditions that the market mechanism insures the establishment of one price in the market for any particular commodity or factor at any one time, i. e., the price which would equate the quantity demanded and the quantity supplied. Any price differences which existed in separated markets for the same product or factor would be fully accounted for by costs of transportation or move-

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nomic theory in general. Listed later under a continuation of the numbering started here will be assumptions which have particular significance with regard to free trade policy recommendations. For this outline of assumptions, the author has relied mainly on the statement, discussion and critique of the assumptions of international trade theory contained in Ellsworth, op. cit., Chap. 5; Delbert A. Snider, Introduction to International Economics, 1958, p. 31; John H. Williams, "The Theory of International Trade Reconsidered," Readings in the Theory of International Trade, 1949, pp. 254-271; and C. P. Kindleberger, Economic Development, Chap. 14.

5 The exception to (c) relevant for international trade is noted below in assumption (9), p. 19.

ment. The price would be free to fluctuate, however, in response to any changes in particular market demand and/or supply schedules.

For purposes of analysis, the influences which lead to changes in demand and supply are assumed given under the ceteris paribus assumption, i. e., preferences, incomes, etc. remain unchanged, except as changes are postulated in order to analyze the effect of such changes on the market equilibrium.[6] In the basic theory regarding the factor-allocative function of the market, the supply of land, labor, money capital and "fixed" capital goods is taken as given. The supply of other capital goods is analyzed in much the same manner as that of any other product.[7]

Relative price fluctuations in the free competitive markets would ration the existing supplies of the various products and factors among their various possible uses according to the desires, willingness and ability to pay of the buyers and guide the production decisions and/or quantities supplied by sellers, i. e., cause changes in the quantities of the various products and factors which are demanded and supplied. If individuals behave as postulated, there would be a continual, automatic tendency toward a stable equilibrium,[8] so far as the variables endogenous to the market are concerned, which involves an equality between the quantity demanded and the quantity supplied, price and per unit cost,

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6 The assumption of "other things being equal" in market analysis has contributed to a static character in international trade theory. See below, p. 37.

7 This fact has special significance for underdeveloped countries as noted below, pp. 25f.

8 An exception to this would be when a time lag in adjustment of supply to price changes resulted in disequilibrium conditions as described in the "cobweb theorem". See M. Ezekiel, "The Cobweb Theorem", Quarterly Journal of Economics, XII, February, 1938, pp. 255-80.

and factor payments and marginal revenue product of the factor.

The stable market equilibrium would involve an apportionment of resources, i. e., productive factors and income of consumers, so that the advantages would be equal in all uses. According to Professor Boulding, this "principle of equal advantage...includes both monetary and non-monetary advantages."[9] However, non-monetary considerations are never incorporated into the body of the theory, being discussed only as reasons why the logical (one price) results of the solely pecuniarily oriented theory are not fulfilled. In fact, demand and supply schedules are depicted as though demand and supply were functions of price, i. e., monetary considerations, and price alone. It is on the basis of the assumption of economic rationality that "non-monetary advantages" are presumed to have a money value placed on them by individuals.

According to the theory, then, unless some force exogenous to the market should intervene to start a chain of adjustments toward a new equilibrium, there would be no change that an individual could make in the use of his resources by which he could improve his position. In fact, he could only worsen it.

One additional characteristic of the equilibrium toward which the operation of this system tends is the automatic realization of full employment of all productive resources. In other words, full employment is a sixth assumption of the value theory that is basic to traditional international trade theory. This assumption is implied by the free fluctuation of price which brings equality between quantity demanded and

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9 Economic Analysis, p. 185.

quantity supplied in the market for every factor of production.

Additional assumptions of both theories usually merely implied or subsumed in the ceteris paribus assumption are (7) a given state of the arts, i. e., technology, and (8) given tastes. In traditional international trade theory, both technology and tastes have been treated as though they remained the same after trade is opened internationally as they were before trade.

The general practice in economic analysis is to start with simplifying assumptions for a theoretical first approximation and then to engage in a step by step qualification of the assumptions in applying the basic theory to the complex conditions encountered in particular real-world problems.[10] It is contended subsequently that the modifications and qualifications commonly made in international economic analysis are in effect largely ignored by "free trade" policy recommendations.[11]

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10 The major modification of the theory so far presented which has been incorporated into value theory is the "imperfect competition" analysis originated by Chamberlin and Robinson and surveyed by B. F. Haley in "Value and Distribution", Survey of Contemporary Economics, 1948, pp. 16-24. A classic application of this modification to international trade theory is that of G. Lovasy, "International Trade under Imperfect Competition", Quarterly Journal of Economics, LV (1941) pp. 567-583. The whole body of income analysis originated by Keynes has influenced international trade theory mainly in its financial or balance-of-payments aspects rather than the "pure" theory.

11 Ellsworth "admits" in The International Economy, 1958, p. 85, "But if more facts must be taken into account, the model must be modified to deal with them. If this modification can be made successfully, the explanatory value of the theory is retained. We shall find that even further qualifications have to be introduced, all of which complicate our theory. But the facts of life are complex. It would be most convenient and gratifying if we could explain them by reference to a single touchstone of limpid clarity and unequalled simplicity. If this

International Trade Theory Assumptions. Based on the assumptions already listed and others pertinent primarily to the international economy, orthodox international trade theorists have concluded that all countries gain from an international exchange of commodities, based on comparative cost advantages which permit international specialization and division of labor. The further assumptions are (9) perfect mobility of the factors of production domestically, but perfect immobility of productive factors internationally; (10) a fixed pattern of productive resources distribution, at least to the extent of being a matter merely of the historically determined stage of development, and (11) single, known production functions appropriate for the production of each particular product.[12]

In order for the conclusion that all countries gain from an international exchange of commodities to have significance even as a first approximation to reality, all of these assumptions of traditional international trade theory must be valid, or nearly valid, descriptions of a real situation. The conclusion does not lose all significance by failure of the conditions of any one postulate to be met, but the probability involved in the stated conclusion is lessened by

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is impossible, if simple explanations are misleading, we must reconcile ourselves to using an elaborate kit of tools to deal with complex problems."

12. Assumptions 10 and 11 ordinarily have not been explicitly stated although 10 is inherent in the ceteris paribus assumption. Both assumptions are implied in the discussions of benefits from free trade policy which talk of specialization based on the cost advantages of each country in the production of commodities which use mainly the relatively abundant resources and economize the use of the relatively scarce resources. Furthermore, assumption 11 is clearly implied in the

each such failure.

The subsequent criticism of the traditional assumptions indicates that modifications and qualifications of traditional international trade theory are required when applying the theory under the conditions in underdeveloped countries. The effect of those modifications is to reduce the probability of the validity of the conclusion that all countries gain from the international exchange of commodities. Each such modification increases the number of instances in which such gains from trade are, in fact, not realized.

The Free Trade Policy Recommendation

The preceding observations become particularly important when we turn our attention to questions of policy, for on the basis of the conclusion as to the gains to be derived from the international exchange of commodities, the recommendation is made that free international trade policy is the most appropriate policy for all nations.[13] It is a

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discussion of international trade that runs along lines of "capital intensive" and "labor intensive" industries. See Romney Robinson, loc. cit.; Ellsworth, op. cit., pp. 82-85; Kindleberger, op. cit., p. 243.

13 Although modern writers in the field of international trade theory have contributed to extensive modification of traditional theory through criticisms of various points, a brief look at the various standard introductory texts on the subject indicates that the various forms of governmental restriction are still condemned or frowned upon, even when their purpose is accorded some degree of validity as in the case of infant industries. Non-interference is considered, at least in some sense, "ideal". See especially Ellsworth, op. cit., pp. 198-205. Ellis and Metzler also suggest this, "...the pure theory of international trade was sorely in need of improvements which would bring it abreast of modern price theory. It is surprising, nevertheless, to find that the improvements in international price theory, when they were finally made during the inter-war years, affected the basic conclusions derived from the classical theory only to a moderate extent. On questions of commercial policy, for example, Mill and Scitovszky are in substantial agreement, even though their methods of analysis and their underlying

long jump from concluding that all countries gain from international exchange given the simplifying assumptions of the traditional theory to recommending that all countries will be better served economically with a free trade policy.

This jump involves a number of errors in logical reasoning. One of these is the tendency to think only in terms of extreme alternatives of free trade or no trade.[14] Another of the errors of logic frequently committed in this policy recommendation is a confusion between a whole and its parts, i. e., that what is good for all countries is good for each one.[15]

This jump from conclusion to policy recommendation is viewed with skepticism by representatives of underdeveloped countries. Underdeveloped countries today appear to be determined to develop economically with special emphasis upon industrial development, and solely on grounds of economic welfare considerations this determination appears rational.[16]

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price theories are considerably different". "Introduction", Readings in the Theory of International Trade, p. viii. This is hereafter referred to as Readings.

14 Witness one of the most recent discussions of trade policy by C. P. Kindleberger, op. cit., Chap. 14. A notable exception is to be found in P. A. Samuelson, "The Gains from International Trade", Readings, pp. 239-252.

15 Scitovszky points out, "Free trade can be shown to be beneficial to the universe as a whole but has never been proved to be the best policy also for a single country." "A Reconsideration of the Theory of Tariffs", Readings, p. 358. He adds that Edgeworth made this charge of error and then goes on to say, "Later economists either persisted in the error pilloried by Edgeworth or adopted the following somewhat defeatist attitude. They declared that owing to the impossibility of interpersonal utility comparisons it was impossible to choose among alternative trade policies from the point of view of a single country." (p. 359).

16 Scitovszky observes, "...Free trade favors whichever line of activity is already best established in a country...Since the progress

We proceed, therefore, to an evaluation of the applicability of a free international trade policy recommendation to the peculiar circumstances of underdeveloped countries in light of their needs for the attainment of rapid[17] economic development.

FREE TRADE POLICY VERSUS DEVELOPMENT IN UNDERDEVELOPED COUNTRIES

The Traditional Assumptions Criticized

It might first be observed that the world is not a world of perfect or even pure competition. On this point there is no real dispute. There is, however, an unresolved debate over whether it is a world in which there is "effective" competition. The importance of this issue to the underdeveloped countries is that the free-competitive-market system, operating through the price mechanism, is presumed to allocate resources to the satisfaction of future wants, i. e., to economic growth, as well as to the satisfaction of present wants.[18]

Furthermore, there are two broad views regarding the dominant reason

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of our material welfare depends mainly on technical advance, our civilization offers the greatest rewards to industrial skill and technical ingenuity, and the nations specialising in these fields will inevitably lead, and agricultural nations lag behind. Hence, the best long-run policy a nation can pursue is to create an atmosphere favourable to industry and technical progress." Ibid., p. 386.

17 Myrdal, in his An International Economy, p. 174, emphasizes the need for as rapid a rate of economic development in underdeveloped countries as possible due to the increasing population pressures that have resulted from reduction in infant mortality and the spectacular rise in life expectancy. Buchanan and Ellis in Approaches to Economic Development and Viner in International Trade and Economic Development favor gradualism, even suggesting that development can only be a slow, long-run process.

18 Schumpeter, in Capitalism, Socialism, and Democracy, and more recently Galbraith, in American Capitalism, assert that it is precisely those industries that are most nearly perfectly competitive that have lagged behind in productive improvement.

for the non-existence of free private enterprise where it does not exist. Some see the primary peril to free choice in government usurpation of economic enterprise and/or interference with private enterprise. Others see the primary danger in private concentrations of monopolistic power interfering with and/or preventing freedom of enterprise.

Competition and the Role of Government. Whatever the influences responsible, there are countries which have lagged behind others in economic--especially industrial--advancement. Furthermore, there has not been, either before World War I, i. e., before the period of widest restrictions on international trade, or since, any great upsurge of private entreprenuerial initiative to narrow the gap. Recognition of this fact[19] has led to the conclusion in underdeveloped countries that if economic development is to come, it will have to come either through direct government economic activity or through special stimulus to private enterprise on the part of government,[20] or both.

Even direct government activity is not necessarily incompatible with the modern interpretation of a laissez faire policy of government. Early nineteenth century liberalist philosophy tended to view the legitimate role of government as being essentially only passive protection both internal (police) and external (defense). Today, nineteenth century liberalist philosophy has evolved to the point where it can view as legitimate government action, in the economic sphere, projects

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19 Among others to be detailed subsequently.

20 Special assistance by government is being regarded necessary today because of the special obstacles to development in this century which did not exist in the last century. See Kleiner, "Economic Development: Nineteenth Century and Today," Current Economic Comment, Aug. 1955, pp. 3-12.

"...that private business cannot or will not go ahead on...to use resources most efficiently."[21]

With reference to both direct and indirect government economic action, Easterbrook, in the Hoselitz symposium, makes some cogent remarks in regard to Canadian experience in seeking to develop. These remarks have relevance for all underdeveloped countries:

> ...the real issue here [Canada] was not that of state versus private control but the creation of an environment in which economic and political expansion could be achieved in the face of obstacles so great that only the big organization could operate for any period of time...Where risks are great, only the biggest bureaucracy can carry on, and not uncommonly this has been the state. As risks lessen, the private firm with state support is enabled to invest with some hope of commensurate return. It is only in unique environments that state action may retreat well into the background, with some allowance for lag in the process. (p. 66)

> There is implicit in the title of this paper the assumption of freedom of choice; once we know which is the better life, we have only to choose and act accordingly. Yet the dominance of either form is more than a matter of the wisdom and preferences of enlightened leadership...We need to know much more about the setting of economic activity before we can get at the conditions of enterprise freedom or lack of it. (p. 68)

> I have suggested that in the comparatively weak and vulnerable economy of Canada the range of choice was at best limited and that there was never at any time the prospect of the enterpriser breaking out in a rash

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21 Shultz and Harriss, American Public Finance, p. 21. Shultz and Harriss go on to say that his position is sometimes broadened to include the view that government action is justified in cases where private groups "...will not adequately prepare for the distant future." It is their opinion, however, that this "...argument has been greatly overworked."

of rugged individualism. (p. 69)[22]

The last observation is precisely the point intended in the present study.

Fixed Pattern of Resources. The assumptions of traditional international trade theory imply that the most important economic problem is the accomplishment of the most efficient allocation of already existing productive resources. But it is precisely a change in the existing pattern of productive resources that underdeveloped countries require for development. It is capital scarcity relative to labor and/ or land--but especially labor--and the resultant low per capita income level in these countries that places them in the underdeveloped category. Consequently, the most imperative economic problem from the standpoint of the underdeveloped countries is enlargement of the scarce resources rather than better allocation of the existing resources.

In classfying productive resources, we can narrow the categories of land and labor to the extreme of natural resources in their primitive state and human effort in its primitive state. This permits restatement of the primary economic objective of enlarging scarce resources as the accumulation of all types of capital in all sectors of the underdeveloped economies.

It is capital most broadly defined, as man made "means" of production, that is the scarce resource in all underdeveloped economies. This includes capital as financial resources, and capital as intangible

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22 Easterbrook, "State Control and Free Enterprise in their Impact on Economic Growth", The Progress of Underdeveloped Areas, ed. B. F.

assets such as general and technical education, training and skills, as well as capital as a stock of physical goods useful in production.

Factor Mobility. There are two broad sources of capital: (1) domestic creation, which involves development of new capital producing enterprises either governmental or private, and (2) acquisition from foreign countries, which involves mobility of this productive factor internationally. Contrary to the assumption of immobility of factors internationally, there is no special reason why capital in the form of interm ediate goods should not move in international exchange like any other product.

On the other hand, domestic creation of capital in underdeveloped countries requires action predicated on a lack of validity of the internal mobility aspect of the international-trade-theory mobility assumption. The exchange activities in underdeveloped countries are predominantly raw-materials exporting and service activities in a few metropolitan areas. Yet the principal domestic economic activity, in terms of the per cent of the population engaged, is subsistance agriculture. In this situation, failure of the assumed perfect factor mobility domestically creates the difficulty for development.[23] This is the main burden of the Singer argument, i. e.,

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Hoselitz, pp. 60-70.

23 Williams points out, "Inferior organization of capital and labor in the more backward country, inferior domestic banking, inferior internal means of communication, inferior perception of economic opportunity--these are obstacles to free movement which far outweigh those commonly cited as impediments to the movement of factors from the more advanced countries. The movement of capital, and to a less degree of labor, is therefore likely to be more free from a more advanced to a less advanced country than is the internal mobility of factors in

that the export economy and the domestic economy of underdeveloped countries have proved to be quite emphatically segregated insofar as intercourse between the economic forces at work in the two sectors is concerned.[24]

Optimum Welfare Results of Free Market Systems. There is a feeling in underdeveloped countries of the need for diversification or balanced growth which has not occurred in these countries. There are potential gains to be derived from diversification of domestic economic activity, i. e., domestic specialization, as well as from international specialization. In view of the failure of concentrated economic activity in the export sector of the economy to bring a level of economic wellbeing comparable to that of the more highly developed--synonymous at this point with diversified--economies, the feeling of need for diversification domestically is understandable.

The advantages of specialization are too well known to require much elaboration here. They are, however, of special significance for underdeveloped countries facing the problem of breaking out of the so-called vicious circle of poverty.

The profitableness of an investment in private enterprise depends, at least in part, on the size of the market. Because of the low incomes in the underdeveloped countries, the size of the domestic market for most products and services is insufficient to justify investment on the

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the latter. This is part of the explanation of great cosmopolitan seacoast cities...nearer to Europe in...contacts and characteristics than to their own interiors..." op. cit., p. 261.

24 H. W. Singer, "The Distribution of Gains between Investing and Borrowing Countries," American Economic Review, Papers and Proceedings,

part of private individuals whose motivation is primarily the maximization of profit in a relatively short period of time.[25]

External economies of investment, broadly defined for underdeveloped countries, involve potential social benefit which justify investments in particular industries, not justified by the purely private profit considerations of general equilibrium theory.[26] This is true because pecuniary, i. e., profitability, external economies, which are experienced by other industries than the one in which investment originally occurs, are not reflected in market prices receivable by the original investor. Although pecuniary external economies tend to exist in all economies,[27] future markets for goods and securities help to reduce the discrepancy between private profit and public benefit from investment in advanced economies. On the other hand, inadequately organized money markets which are necessary to support future markets contribute to making the private

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Vol. XL, May 1950, p. 475.

25 See Nurkse, Problems of Capital Formation in Underdeveloped Countries, chap. I.

26 See Tibor Scitovsky, "Two Concepts of External Economies," Journal of Political Economy, April 1954, pp. 143-151. Scitovsky distinguishes "Technological" (or productivity) external economies of general equilibrium analysis, examples of which are relatively few, and "pecuniary" (or profitability) external economies implied in discussions of balanced growth needs in underdeveloped countries. He points out that, in a situation where investment in one industry, A, causes profits to arise for another industry, B, expansion in which in turn raises profits further for A, investment based on private profit would not be as much as was socially beneficial unless expansion in both industries was simultaneous. Scitovsky lists five possible sources of such "pecuniary" external economies and concludes that, "It is apparent from this list that vertical integration alone would not be enough and that complete integration of all industries would be necessary to eliminate all divergence between private profit and public benefit." p. 149.

27 For reasons discussed by Scitovsky, ibid., pp. 147-150.

profit-public benefit discrepancy in underdeveloped economies quite wide.

Another aspect of the discrepancy between private profit and social benefit derived from investment arises when the distribution of benefits from investment is considered from the international point of view as opposed to the national point of view. To the extent that private profit does indicate social desirability of investment, it does so without distinguishing the nationality of the recipients. There are pecuniary external economies from investment in export industries, as opposed to import-competing industries, that benefit foreigners, and there are pecuniary external diseconomies suffered by foreigners which result from investment in import-competing industries.[28] Therefore, private profits from investment approximate benefits to persons all over the world more nearly than it does benefits to persons in individual countries where the investment occurs.

The result for underdeveloped countries is an overstatement of the profitability of investment in export industries compared with the profitability of investment in import-competing industries. The overstatement of profitability of investment in export industries is reflected in market prices when the total of benefits received, by whomever, are the basis for judging profitability of an investment instead of just those investment benefits received by nationals.[29]

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28 Ibid, p. 151.

29 This case is, in one sense, a reverse of the preceding situation where the discrepancy (within a country) between private profit and public benefit from an investment was due to the failure of the price system to take account of enough returns from investment. In this the price system takes account of too much return from investment so far as domestic social benefit is concerned.

This difference in viewpoint, i. e., international versus national, has led to the argument over the effects of the terms of trade on raw-materials-exporting countries. If the terms of trade have turned against raw-materials-exporting countries as contended by those who take the national point of view, there is justification for stimulating investment in non-export industries, i. e., industries producing for the domestic market--either import-competing or purely domestic industries.[30]

The whole question of the distribution of benefits from particular investments raises the problem of just what industries may be justified on economic grounds as recipients of encouragement from policies designed to achieve development. The choice of industries for promotion is a decision which has to be made by any country deliberately seeking to develop, but it is a problem which is beyond the scope of this study.[31] An implication of the preceding discussion, however, is that the range of economically justifiable choice of industries for development, at least from each individual country's domestic point of view, is broader than can be justified by traditional trade theory based upon compara-

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In anticipation of analysis in a later chapter, it may be noted that the external diseconomies of investment policy oriented around narrow domestic benefit that are suffered by the rest of the world in the relatively short period may be offset in the long run by effects of increased income in underdeveloped countries.

30 See Singer, loc. cit., also United Nations, Economic Commission for Latin America (R. Prebisch), The Economic Development of Latin America and Its Principal Problems, 1950.

31 The task selected for this study is to analyze the potentialities and the results of using commercial policies to aid in effecting development regardless of whatever lines are determined suitable. See above, p. 1.

tive advantage[32] and general equilibrium analysis.[33] Furthermore, there are two other aspects which tend to indicate a wider range of such choices, but which are commonly slighted in discussions relating to these decisions, i. e., transport costs and international monopoly forces.[34]

Transportation Costs and International Markets. Transport costs have been abstracted from in most discussions of international specialization based on comparative cost advantages. Transport costs were said to affect relative prices and therefore the volume of international trade, but not the basic principle.[35]

While transport costs do not affect the basic theoretical principle,

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32 Romney Robinson, loc. cit., criticizes comparative advantage theory because it, "...treats international trade as a means of reallocating already existing factors of production so as to increase output." (p. 346). Robinson attempts to show "...that such an account is misleading, the most important aspect of trade being its stimulus toward creation of new (italics Robinson's) productive factors, the resulting gains being far in excess of those likely to be derived by raising the marginal product of existing factors." (p. 346)

Although there are still vast gains to be derived from international specialization, the nature of that specialization is not solely dependent upon already existing factor endowments. Robinson's analysis is the most telling blow to the traditional comparative advantage explanation of international trade yet put forth.

33 See J. E. Meade, Trade and Welfare, Vol. II of The Theory of International Economic Policy, 1955, esp. chaps. VIII, XVI and XXVI, for a thorough general equilibrium treatment of the issues involved in such policy decisions.

34 The latter involves violation of assumptions 2 and 4 above, p. 15.

35 Ellsworth makes this observation in the 1950 edition of The International Economy, chap. 6. In the 1958 edition, he says, "We can now take account explicitly of the fact that the movement of goods involves costs, often heavy, that exert a strong influence upon the course of trade and upon the location of industry. p.(113.)

they do affect what it means for the pattern of specialization as between developed and underdeveloped economies. Failure to develop adequate transportation facilities in underdeveloped economies may preclude, for them, development of additional domestic industries that would be entirely justified even on the basis of traditional comparative-advantage analysis. "Products that should be available domestically may be imported from foreign sources thousands of miles away because transport over much shorter distances is impossible."[36]

Transport costs also affect the distribution of the gains from international specialization and trade through the difference in relative importance of transport costs in the delivered cost of different types of goods. Transport costs as a percentage of total cost are low for commodities of relatively high value per unit of weight (e. g., most manufacturers) and high for commodities of relatively low value per unit of weight (e. g. most primary goods).[37] At the same time, advanced countries hold a position of relatively greater importance in the transport industry.[38] These two facts combined mean that the accrual of payments for transportation of goods internationally as a proportion of the gains

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36 W. Owen, "Transportation and Economic Development," American Economic Review, Papers and Proceedings, XLIX, May 1959, p. 179.

37 C. Moneta, "The Estimation of Transportation Costs in International Trade," The Journal of Political Economy, pp. 41-58. Moneta observes, "This ratio (of transportation cost to total cost) is an inverse function of the value per ton of the commodity, so that for very high-valued items it may approach zero and for low-valued items it may approach one." p. 41.

38 The readily available data gives only a rough indication of the fact. For example, in 1957 the registered merchant shipping tonnage and the air cargo ton-kilometers of "developed" countries each amounted to about four times that of "underdeveloped" countries. Estimated from tables 138 and 141 of the United Nations, Statistical Yearbook, 1958, pp.

from trade--especially in regard to the primary-goods exports of underdeveloped countries--is heavily in favor of developed countries.

Competition and Monopoly. The percent by value of international trade conducted under monopoly or cartel conditions has been variously estimated at from one-third[39] to one-half[40] of all international trade during the interwar years. While cartel activity in primary products exported by underdeveloped countries has been most widely researched and reported, a great deal of cartel activity also has been in the area of basic metals processing, chemicals and other manufacturing industries.[41] The purpose, among others, has been to maintain price above cost through restriction of supply and prevention of the development of new competing sources of supply.

In order to obtain lower costs of large scale production and still restrict supply, cartelized firms in advanced economies have sold their surplus production abroad at prices below cost. While this practice might seem to favor underdeveloped countries, its effect has been to prevent the development of the affected industries in the underdeveloped countries without providing a reliable source of the products. Fluctuations in demand and in production have meant that exportable surpluses existed at some times and not at others.

The effect on underdeveloped countries has been to hinder the creation of new industries which, once they were established, might be

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309f and 321ff.

39 By Machlup in A Cartel Policy for the United Nations, Corwin Edwards, ed., 1945, p. 11.

40 Edward Mason, Controlling World Trade, p. 26 fn.

41 See E. Hexner, International Cartels, Part Two: Case Studies, p. 181ff.

able to compete on the basis of cost in the domestic markets for such products and increase domestic incomes.[42]

Saving and Free Market Provision for Growth. Capital accumulation requires saving as well as investment, and these requirements are affected by the low-income aspects of the "vicious circle of poverty" in underdeveloped countries.[43] Incomes, both money and real, are very low so that most income goes for merely sustaining the populations at bare subsistence, or even lower, levels of living with very little possibility for saving.[44]

Extreme inequality in the distribution of incomes in these countries[45] further compounds the problem of achieving adequate saving for development. The small percent of the population who receive a very large percent of the total income have very little incentive to save for investment because of the lack of investment opportunities.[46] These wealthy tend to spend on consumption of imported luxuries or living on the Riviera, rather than to save.[47]

The amounts which the wealthy elite do save they tend to "invest" in relatively safe securities in advanced countries or in land and real

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42 It will be readily perceived that this point touches on both the infant-industry and anti-dumping arguments for protection.

43 Nurske, op. cit., p. 5.

44 United Nations, National and Per Capita Income in Seventy Countries, 1949, p. 14.

45 Kindleberger, op. cit., p. 8.

46 The previous discussion regarding the importance of the size of the market and regarding external economies from investment is pertinent to this point. See above, p. 27.

47 This practice is a possible target of commercial policies discussed later. See below, p. 74.

estate in anticipation of appreciation in the value thereof as population pressures increase. Thus creation of diversified types of venture capital is neglected due to the quest for asset security and the fact that the domestic markets for the products of venture capital are so small. All of these practices of the wealthy elite are part of the reason for the feeling in underdeveloped countries that initially the development process requires direct government investment, at least in social overhead capital, and/or encouragement of private investment.

Employment and Labor Mobility. One other important circumstance in most underdeveloped countries, which holds considerable potential for influencing balanced growth, which constitutes both a problem to be solved and a potential asset, and which involves another failure of the assumptions of traditional international trade theory to be fulfilled, is the existence of considerable underemployment, i. e., disguised unemployment, of labor.[48] Disguised unemployment constitutes a violation of both the traditional assumption of full employment of resources and the assumption of the internal mobility of resources. This type of underemployment, which is especially characteristic of the subsistence agriculture of the underdeveloped countries, involves a surplus of labor in agriculture.

Under these circumstances a shift of laborers out of agriculture could be effected without reducing the total agricultural output. In some instances, it might even increase output. The latter would occur

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48 See United Nations, Department of Economic Affairs, Measures for the Economic Development of Under-Developed Countries, 1951 pp. 7ff.

if the point where marginal physical output of agriculture labor became zero had been passed. This tends to be true of the heavily populated countries. The shifting of such labor out of agriculture would tend to increase the total real income of the country, although problems for those shifting would be serious.

Such a shift would be speeded and the accompanying difficulties eased by policies affecting both domestic trade and foreign trade which stimulated diversified development of domestic economic activity. This shift of labor would be a continuing process if economic development could be maintained. The process would be stimulated by improved agricultural techniques including mechanization, just as it has been in the case of every country that has experienced long periods of economic growth. Thus economic development of underdeveloped countries cannot concentrate on industrialization to the exclusion of agricultural improvement.

Policy Implications.

The foregoing discussion of the assumptions of traditional international trade theory tends to indicate that commercial policies alone cannot bring development. It is generally agreed that one of the principle tasks of development in underdeveloped countries is creation of capital, and that this requires investment, either foreign or domestic, that will result in balanced growth. For private investment in varied enough lines to be forthcoming, the climate must be right. The most important economic prerequisite for the creation of such a favorable climate for private investment in underdeveloped countries is the creation

of social overhead capital--e. g., education and training facilities, transportation facilities, communication facilities--investment in which is not profitable enough in the short period to attract private investors and entreprenuers.

Facilities of this type have been developed by export enterprises to serve their own needs in many of the underdeveloped countries, but development of such facilities to serve the domestic sector of their economies is essential if these countries are to achieve diversification. Creation of social overhead capital would tend to stimulate private investment, not only by making possible the expansion of the domestic market geographically, but also by expanding the domestic market in terms of increased effective demand resulting from increased incomes. Yet, unless production of consumer goods is increased at the same time, increased money incomes would lead to inflation. Inflation is an ever-present tendency and threat to development in underdeveloped countries.

The initial steps toward accumulation of varied types of capital in underdeveloped countries have to come from government as the only institution with a long enough life expectancy to reap the full rewards from investment, the returns from which can only be realized in the relatively distant future. Thus, free private, i. e., capitalist, enterprise which is assumed in the free trade theory will tend to assume the responsibility for diversified capital creation in underdeveloped countries only after the groundwork has been laid by governments. As pointed out previously,[49]

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49 See above, p. 25.

this is not inconsistent with the laissez-faire philosophy, which holds that the only proper functions of government are those that private enterprise either cannot or will not do. Furthermore, original government stimulus to economic growth in the early stages of development has been common in the history of every country, even in the history of United States' development. In other words, development in every case has been initiated, at least partially, by state action.

As noted earlier,[50] Easterbrook concludes that the conditions under which Canadian development has occurred have been such as to preclude a choice between private action and government action. The considerable degree of imperativeness and of risk involved in the task of initiating development in the currently underdeveloped countries tends to preclude a choice between private action and government action for them in much the same way, though for different specific reasons, that it did for Canada in her early stages of development. For various socio-politico-eco-historical reasons, opportunity for private enterprise lies in conjunction with government action. In underdeveloped countries, private enterprise is enabled to invest with increasing prospects of adequate return only as government acts to reduce risks.

The failure of traditional international trade analysis to be concerned with economic growth is to a large extent due to the static nature of the theory imposed upon it by its assumptions. Furthermore, the assumptions have been developed essentially only in terms of the institutional

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50 See above, pp. 25f.

framework of Western Europe and North America.[51] The making of policy recommendations for all countries on the basis of economic generalizations derived in such restricted manner fails to heed the admonition of Marshall:

> Though economic analysis and general reasoning are of wide application, yet every age and every country has its own problems; and every change in social conditions is likely to require a new development of economic doctrines.[52]

The analysis of economic development has been sporadic and essentially only a fringe concern in the development of economic thought.[53] Further, the development analysis which has occurred has been mainly concerned with the problems of maintaining growth or preventing stagnation rather than with the origins of economic development. In short, we have no satisfactory general theory of economic development, especially of the origins of development which are the main concern of the underdeveloped countries.[54]

However, it is not our purpose in this study to attempt the development of such a theory. Since there are not satisfactory theoretical guide lines to proper policy for development, the various underdeveloped countries have embarked upon development programs on a more or less trial and error basis. We have, therefore, selected as the task of this study an analysis of the potentialities of planning foreign trade controls to co-

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51 H. F. Williamson, "Comment" (on "Economics of Growth" by Abramovitz), A Survey of Contemporary Economics, Vol. II, 1952, p. 182.

52 Alfred Marshall, Principles of Economics, eighth edition, p. 37.

53 M. Abramovitz, "Economics of Growth", A Survey of Contemporary Economics, Vol. II, 1952, p. 132.

54 This can be partly accounted for by the fact that many of the determinants of the origin of economic development lie outside the traditional boundaries of the study of economics. Two interesting tentative efforts at devising this are W. W. Rostow, The Process of Economic Growth, 1953,

incide with and complement other policies for development rather than conflicting with and hindering them.

Summary

To summarize, we have pointed out: (1) That the frame of reference of traditional international trade theory is not very well suited for analysis of the special problems of underdeveloped countries for two main reasons: (a) its assumptions are incompatible with the social, political and economic institutional framework of the underdeveloped countries, and (b) it leads to misplaced emphasis as regards the selection of the most vital problems to be solved, i. e., emphasis upon the problem of allocation of existing resources rather than on the problem of originating the process of economic development. (2) In view of (1), it is inappropriate to make international trade policy recommendations for underdeveloped countries based on traditional international trade theory, even though the conclusions as to the gains from international trade, given the assumptions of traditional theory, are logically consistent. (3) Some of the basic needs for development include: (a) formation of capital of all types and in all sectors, and, therefore, increased levels of saving and investment, (b) increased domestic mobility of resources, especially labor, from the agricultural sector to the industrial sector, (c) stimulus of production for the domestic market through the creation of social overhead capital to serve the entire economy rather than the export sector only. (4)

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and S. Kuznets, "Toward a Theory of Economic Growth," in R. Lekachman, ed., National Policy for Economic Welfare at Home and Abroad, 1955.

The outpouring of publications on the subject appears to have been increasing at an increasing rate over the last ten years. See the accompanying bibliography.

Control of foreign trade can contribute to the fulfillment of the general needs listed under (3).

The last observation points up the purpose of this study, i. e., to analyze the possible uses and effects of commercial policies of underdeveloped countries as they may be, and are, directed toward the attainment of economic development. The following chapter gives a brief description of the general nature of commercial policies which may be used to combat the special problems that arise out of attempts to develop, as well as an introductory discussion and organization of the problems to be attacked.

CHAPTER III

COMMERCIAL POLICIES AND DEVELOPMENT OBJECTIVES

This chapter is designed to lay the groundwork for the more detailed analysis in the subsequent chapters. The meaning of the term "commercial policies" is delimited by a description of the instruments of control to be included in that category for purposes of this thesis. The importance of unifying commercial policy formulation toward development is emphasized. The broad, interrelated development objectives most susceptible to influence by commercial policy instruments are explicated. Finally, the specific commercial policy objectives, fulfillment of which will contribute most directly to achievement of the development ends, are elaborated.

Governmental interference with market mechanisms operates through controls affecting incomes, prices, and quantities of goods and services demanded and supplied. The various instruments of governmental interference lend themselves in varying degrees of effectiveness to control over more general economic variables--e. g., totals of income, consumption, and investment--or to control over more specific economic variables--e. g., incomes of particular products and services, and investment in particular industries or sectors of the economy. It is in these terms of relative effectiveness that the nature of commercial policies and their development uses are discussed in this chapter.

THE NATURE OF COMMERCIAL POLICIES IN THE CONTEXT OF THIS THESIS

The policy techniques included in the category "commercial policies" has never been a matter of standard practice. Like all definitions and

classifications the term is susceptible of varied interpretation to serve particular purposes of study and analysis.[1] Primary consideration of commercial policies in this study is limited to tariffs and foreign trade subsidies, quantity restrictions, and exchange controls to the exclusion of such practices as state trading, international cartels, and international commodity agreements.

Reliance on commercial policies as here distinguished, in incorporating international trade relations in an overall policy for development, as opposed to reliance on state trading for the same purpose indicates a significant difference in approach to the problem of development. Historically, state trading has dominated international trade relations only in those countries already committed to virtually complete control over all economic activity, domestic and foreign.[2] Presumptively, where reliance is on commercial policies as here distinguished, it is the intention of the government to permit a more extensive degree of private enterprise. This is the general tenor of expressions, as well as the specific assertion, of representatives of most underdeve-

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1 Towle defines the term broadly to include "all measures regulating the external commercial relations of a country--measures adopted by a government to assist or hinder the export or import of goods and services." International Trade and Commercial Policy, Harper, New York, 1956, p. 423. Krause excludes "broader monetary and fiscal policies". The International Economy, Houghton Mifflin, Riverside Press, Cambridge, Mass., 1955, p. 229. Snider excludes "international monetary and payments policies." op. cit., p. 371.

For a general classification of the instruments of government control see Table I in H. B. Chenery, "Development Policies and Programmes," Economic Bulletin for Latin America, III, No. I, March 1958, p. 56.

2 Towle says, "Under state trading, tariffs, quantitative restrictions, and exchange controls are superfluous." op. cit., p. 633.

loped countries (with the exception of Communist countries) in their discussions of development programs and policies.[3]

International cartels are excluded from consideration because they are essentially private restrictions on free international trade, not government policy. They have been supported, however, in greater or less degree by various governments.

International commodity agreements are excluded primarily because they are "agreements" rather than unilaterally determined policies. However, it is interesting to note that such agreements have usually been made in connection with commodities that are exchanged in markets which most nearly reflect the perfectly competitive conditions assumed in the free trade arguments. It is in such markets, e.g., primary goods markets, that sellers have proved to be at an economic disadvantage in their relations with the rest of the more imperfectly competitive international economy.

Tariffs

In terms of the use made of them and the analytical discussion devoted to them, tariffs are the most venerable of the instruments of governmental policy in the area of international economic relations. They

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3 See especially United Nations, Economic Commission for Latin America, "The Latin American Regional Market," Economic Bulletin for Latin America, III, March 1958, p. 5, and United Nations, Economic Commission for Asia and the Far East, "Economic Development and Planning in Asia and the Far East, Policies and Means of Implementation," Economic Bulletin for Asia and the Far East, VII, November 1956, p. 3. For a general policy statement in this regard by one important government, see Government of India, "Industrial Policy Resolution," April, 1956, reprinted in Planning Commission, Government of India, The New India, Progress Through Democracy, Macmillan, New York, 1958, p. 387ff.

are taxes or duties levied upon goods and services imported or exported across national boundaries. As tax levies they constitute a source of revenue for government when the base upon which they are levied is existent. Since, however, a tariff increases the delivered price of the dutiable item to the potential buyer, or, alternatively, lowers the potential return to the seller, it may have the effect of preventing the exchange of the dutiable item. Thus, a tariff, like any tax, may reduce or eliminate the base upon which it is levied.

Effects of Tariffs. What the effects of a tariff will be--how much revenue is raised, what changes in prices will occur, what changes will occur in quantities demanded and supplied, what will be the shifts in factor uses--is dependent on market conditions. At one level, these conditions involve the degree of refinement in market organization and facilities as well as the extent of the markets. At another level, they involve the significance of the market structures for the mobility of factors and the knowledge of market conditions in terms of opportunities, uncertainties and risks. Finally, at that level closest to the actual market results, the effects of a tariff involve the more general market conditions in their influence upon the elasticities of demand and supply of products and productive services.

Most analyses and conclusions as to the effects of tariffs have been in the context of well organized markets of highly developed and diversified economies of economically advanced countries. Analysis of the effects of tariffs in the market situations in structurally more rigid economies of underdeveloped countries will yield different results. In either situation, because of the variety and complexity of responses of

supply and demand to change in prices and incomes, the actual effects of tariffs are often uncertain and unpredictable.

Theoretical analysis of a taxonomic nature[4] can detail the possible effects of tariffs under a variety of assumptions, but the actual effects often remain obscure even after they have occurred. Furthermore, tariffs may prove to be ineffective instruments of development policy in underdeveloped countries because they operate through an initial impact upon prices and structural rigidities in many sectors of underdeveloped economies dull the quantity responses to price.[5]

Tariff Laws and Systems. Historically, tariff systems and tariff laws have been marked by variety and complexity. Duty rates are specific, or ad valorem, or a combination of the two. The burden of specific duties varies inversely with the value of the items upon which they are levied. The burden of ad valorem duties remains constant, since the tariff collection rises or falls by the same percentage that the value of the dutiable item rises or falls.

Tariffs may be levied to range from completely non-discriminatory to extremely discriminatory treatment of products and/or countries of

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4 Such as that by Meade, The Theory of International Economic Policy, Vol. II, pp. 193ff.

5 See Meier and Baldwin, op. cit., pp. 316-318.

P. T. Bauer takes exception to this view in his Economic Analysis and Policy in Underdeveloped Countries, Duke University Press, Durham, N. C., pp. 39-41. Bauer's examples, however, are taken from agriculture, especially for export, or from distribution, and do not involve innovations of new techniques in these sectors. The underdeveloped economies vary in the degree to which economic activity has been shifted from subsistence to exchange orientation, but structural rigidities are significant, although in greater or less degree, in all underdeveloped economies, especially in those sectors most important for development.

origin and destination. A completely non-discriminatory tariff applies the same ad valorem rate to every import or export. Such a tariff would raise revenue, but has seldom, if ever, been levied. Historically, tariff systems have involved some degree of discrimination, if only to the extent of allowing some items to enter or leave the country duty-free.

More commonly, tariff systems have been constructed to incorporate considerable discrimination, usually for purposes other than simply raising revenue. In view of all the different rates that may be applied to all of the different dutiable items, with additional distinctions made on the basis of countries of origin or destination, the number of discriminatory combinations is infinite.

Extremely complex tariff systems may be self-defeating of their objectives or may call forth retaliatory policies in other countries that will defeat the objectives. The less extreme the system is with regard to rate levels and discriminatory aspects, the less virulent are retaliatory measures likely to be. Also, the fewer the objectives any one tariff system is designed to achieve, the more successful it will be in achieving those that are set. These aspects serve to bolster the view that with uncertainty as to price and quantity effects of tariffs, elaborate, multi-purpose tariff systems are ineffective or inefficient means of influencing economic behavior of individuals or firms along lines that promote economic development.

The manner in which tariff systems are instituted further increases the relative ineffectiveness of elaborate tariff systems for promoting

development.[6] In non-totalitarian countries, which are the principal concern of this study,[7] tariff systems are usually instituted by an act of parliament. The same is true of important changes in the system. Political realities of parliamentary government make tariff systems, instituted in such manner, inflexible and difficult to change to meet the changing needs and conditions inherent in the dynamic process of development. Since, however, the application of the tariff system is usually administered by an executive agency, some flexibility may be injected into the system by granting the administering agency and customs officials some discretion in its application. In addition, some South American countries have given their chief executive power to change tariff laws by edict, although subject to subsequent legislative confirmation.

Foreign Trade Subsidies

Subsidies to foreign traders are the reverse of tariffs, i. e., they are payments or allowances to exporters or importers rather than levies upon their activities. However, they may be substituted for tariffs for some purposes, although not for raising revenue. Also, subsidies to businesses not engaged in foreign trade may substitute for protective tariffs by improving their relative profit position vis-a-vis foreign firms.[8]

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6 For a general discussion of the form and content of tariff laws see Towle, op. cit., chap. 18.

7 See above, p. 14.

8 While subsidies have many uses, analysis in this study is limited primarily to effects of subsidies on international trading relations as these impinge on development.

Quantitative Controls

Quantitative controls take the form of import quotas or export quotas. As such, they constitute the fixing of specific quantities of goods that are permitted to be imported or exported during a certain period of time. The impact of quotas is on quantities of goods demanded and supplied rather than on prices. Although quotas affect prices, the price effects of both quotas and tariffs depend on many factors and are difficult to predict.

Quantitative controls, as policy instruments, are more certain and precise in their influence on quantites of goods exchanged than are tariffs. This is one reason why quantitative restrictions became so widespread during the interwar period when, for various reasons, control of international trade was more deliberately and frankly practiced.[9]

A quota may be combined with a tariff. By this means, a specified volume of goods is permitted to pass in international exchange at a low duty rate, or free of duty, while any exchange in excess of that volume is subject to a higher tariff rate.

A primary disadvantage of both the simple quota and the tariff quota is the tendency for foreign traders to rush to get in under the quota or at the lower rate. This causes transactions to be bunched early in the quota period, and results in greater price fluctuations.

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9 For a detailed treatment of interwar commercial policy developments see Margaret S. Gordon, Barriers to World Trade, Macmillan, N. Y., 1941. Miss Gordon's study is devoted mainly to quotas and exchange controls. For a study that deals primarily with tariffs and their history see A. Isaacs, International Trade: Tariffs and Commercial Policies, Irwin, Homewood, Ill., 1948.

In practice, an early solution was developed in the form of licensing systems.

Under a licensing system, foreign traders are required to obtain a government license to import or export specific commodities.[10] A governmental agency can spread the quota over the quota period, or dispense with a specified quota for a specified period and control transactions by passing on applications for licenses as they are made. The latter precedure makes the quota system a more flexible instrument of control.

Since quotas control quantities exchanged directly and thus affect quantities more certainly and precisely than tariffs, day-to-day licensing decisions can more effectively discriminate between products and countries of origin and destination to further economic development in underdeveloped countries. An additional element of quota flexibility derives from the fact that specific quota decisions are usually made by an administrative agency.

A further important distinction between tariffs and quantitative controls has to do with the price and revenue effects of the two systems. Whereas tariffs, by their tax nature, involve collection of revenue by the government--except when completely prohibitive--and thereby affect prices, quantitative controls affect prices through their influence on quantities of commodities supplied without guaranteeing that any benefits from price changes accrue to the government in the form of revenue. The direction of the price influence of quotas is generally toward a price

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10 Alternatively, the licensing system may be combined with exchange controls with the licenses authorizing use of foreign exchange for specified purposes. This is discussed below.

rise that results in windfall profits either for the importers, exporters or producers of the commodities affected. Here again a system of licensing quotas can overcome a disadvantage of quotas. Fees charged for quota licenses can capture windfall profits for the government.

The license charges, as well as the dicisions as to whom the licenses will be issued, may be left to the discretion of the administering agency, or the licenses may be auctioned off to the highest bidders. If these decisions are left to the discretion of officials, an additional element of flexibility for promoting development is introduced into the quota system. On the other hand, auctioning licenses will tend to assure the government the greatest revenue possible under the quota system and permit the allocation of licenses to be determined by a modified price system.

Quota licensing may be combined with exchange controls by requiring a license for the acquisition and use of available foreign exchange for specified purposes, rather than licensing the acts of foreign trade themselves. Stated in this way, the implication is that foreign exchange licensing is primarily concerned with controlling imports. This is largely true, although exchange control as practiced usually includes, also, controls on foreign exchange earnings from exporting.

Licenses authorizing the purchase of foreign exchange may carry assurance of the availability of the necessary amount of foreign exchange or grant permission to buy if the foreign exchange is available. In the latter situation greater reliance on modified market forces in the determination of exchange rates is implied. Whichever procedure is followed, most foreign trade licensing schemes and exchange control

systems currently are used together.

Exchange Controls

Exchange control is additionally a separate and distinct instrument of commercial policy. It can be, and is, used to influence the flow of imports and exports of goods and services.[11]

Exchange rates in free markets[12] are determined by the interaction of private supply of and demand for the various national currencies, or, more strictly, the claims to national currencies. The supply of foreign exchange in a particular country is derived from earnings from exports of commodities and services as well as money capital inflows, while demand for foreign exchange is derived from demand for imports of goods and services as well as money capital outflows. Since exchange rates react back on the quantities of foreign exchange demanded and supplied, controls on exchange and exchange rates can influence imports and exports.

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11 See footnote 1, p. 43.

12 Free foreign exchange markets are basically of two types: one in which exchange rates are fixed as under the international gold standard and the other in which exchange rates are flexible. Under fixed exchange rates when there is disequilibrium in the balance of payments, adjustment occurs through changes in price, income and employment levels--deflationary changes in deficit countries and inflationary changes in surplus countries--unless offsetting long-term capital movements are forthcoming. Under flexible exchange rates adjustment occurs through fluctuations in the exchange rates. The principal disadvantage of flexible rates is the possibility of extreme rate fluctuations arising out of destabilizing speculative activities and creating uncertainties and risks that disrupt international trade. In a number of instances where such extreme rate fluctuations have occurred, stabilization through government buying and selling has been attempted, but where large deficits were involved, supplies of foreign currencies and gold have usually proved inadequate for the task.

General Purposes and Effects. Exchange control systems are designed to control the use made of available foreign exchange. Like tariff and quota systems, exchange control systems can be constructed to exercise widely varying degrees of control over international transactions. Their complexity will tend to vary directly with the number of policy objectives they are used to fulfill. Furthermore, the less general, i. e., the more detailed, the objectives of exchange control, the more stringent the controls are likely to be.

Since foreign exchange transactions are usually handled by banks as intermediaries in international trade, it is possible to exercise loose exchange control by having the central bank or even the principal commercial banks simply supervise international payments more carefully. Even in more thorough-going exchange control systems, already existing financial institutions can serve as administrative agencies.

Under more extreme forms of exchange control, the government requires that all foreign exchange earnings be sold to a government agency --the central bank, the treasury, or a specially established exchange control board or commission--and authorizes that agency to allocate such earnings among potential users as it deems necessary to carry out government policy objectives. Such detailed control may be exercized through a system of foreign exchange licensing that not only rations the quantity, but also fixes the exchange rate, i.e., the price of foreign exchange. An exchange control program of this type includes the impact points[13] of both tariffs and quotas, i.e., the prices and the

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13 "Impact" is used here in the tax theory sense.

quantities of foreign exchange and of imports and exports.

Foreign exchange licensing makes possible more effective and complete control over invisibles--services and capital transfers--in the balance of payments than is possible with either tariff or quota systems. Thus, exchange control systems can be constructed to provide a wide range of versatility in their effects on different commodities and other balance of payments items as well as on different countries and their currencies. The advisability of incorporating greater versatility in the system, which means additional complexities, depends upon the existing conditions and the policy objectives of particular countries, as well as on the difficulties of enforcement.

Exchange Control Systems. No two systems of exchange control are the same, for the combination of alternative features is infinite. Broad types, however, can be distinguished in terms of their degree of complexity.

In simple form, there may be established an official exchange rate at which all foreign exchange must be sold to and bought from the controlling agency. The immediate purpose is to mobilize what is a short supply of foreign exchange (which implies a balance of payments deficit) in order to control its use. The official rate of exchange is established by fixing the ratio at which the domestic currency is to exchange for a relatively stable currency, say the U. S. dollar or the British pound.[14]

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14 This practice also fixes the ratio of the domestic currency to all other currencies. Defining a currency in terms of gold, without establishing a gold standard, is another method of doing the same thing.

Since exchange controls are instituted to avoid what are considered less desirable avenues of adjustment in the balance of payments, e.g., currency devaluation or exchange rate appreciation, the official rate established is apt to overvalue the domestic currency (undervalue foreign exchange). Thus, almost inevitably an illegal or "black market" will develop in which buyers are willing to pay a higher domestic-currency price for foreign exchange than the official rate.

A slightly more complicated system that avoids the harmful effects of such illicit activity yet retains some essential control can be established by legalizing the black market. This involves discrimination between different sources of supply of foreign exchange and between different uses. Specified categories of foreign exchange earnings are required to be sold to the control authorities at the official rate, the rest being allowed to be sold on the "free market". Foreign exchange demanded for certain purposes is permitted to be purchased at the official rate from the authorities, the rest of the demand having to be satisfied at the higher free market rate.[15] This is the simplest form of the third and most complicated type of exchange control system, viz., multiple exchange rates.[16]

Deliberately established multiple exchange rate systems of exchange control usually involve the fixing of more than one official rate of exchange, to be maintained with or without a legal "free" rate. Various

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15 Ellsworth calls this a "dual rate system". op. cit., p. 342.

16 The International Monetary Fund defines a "multiple currency practice" as an effective buying and selling rate which differs from parity by more than one per cent as a result of official action. See IMF, First Annual Report on Exchange Restrictions, 1950, p. 144.

official buying rates may be applied to different sources of foreign exchange earnings and various official selling rates charged for different uses to which foreign exchange is to be put. Such multiple rate systems constitute a method of instituting partial devaluation which can be used to pursue a much wider variety of policy objectives than is possible through general devaluation. Furthermore, multiple exchange rate systems provide a government revenue potential, in addition to possible exchange license charges, in the form of profits from purchases of foreign exchange at a lower average rate than the average rate for sales of foreign exchange.

The raison d'etre of exchange control systems is to cope with difficulties associated with balance of payments deficits. Since under inconvertible currency conditions,[17] balance of payments deficits tend to arise vis-a-vis some countries and not others, bilateral trading, clearing, and payments agreements have frequently accompanied exchange control systems. While bilateral agreements are not inherent necessities in the operation of exchange control systems, they have often been resorted to as expedient solutions to particularly pressing problems.

In the literature on international economies, most discussions of the effects of commercial policies have taken the form of discussions of tariffs, with a general extension of these discussions to quantitative and exchange controls. Quantitative and exchange controls are usually deemed to have the same basic effects as tariffs, especially with respect

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17 During 1959 considerable progress was made toward the goal of currency convertibility, especially by European countries. Many problems of inconvertibility remain. See IMF, Tenth Annual Report on Exchange

to their influence on the pricing and allocative operations of the market. The main distinction that is drawn between the market effects of tariffs as opposed to either quantity controls or exchange controls is that while the imposition of a tariff constitutes interference with market forces, once it is imposed the market forces are free to adjust to the new price situation created by the tariff without further interference. Quantity and exchange controls, on the other hand, are presented as involving continuing interference on the part of governmental authorities.[18]

THE SIGNIFICANCE OF MAKING DEVELOPMENT THE DOMINANT CONSIDERATION IN COMMERCIAL POLICY FORMULATION

Past Commercial Policy Objectives

The purposes of commercial policies usually cited are obtaining government revenue, protecting domestic producers, and protecting the balance of payments.[19] These purposes are general in nature and as such are susceptible of partial accomplishment by tariffs, even though a particular tariff levy cannot serve well both as a revenue and a protective device. Even for these general purposes, however, many countries learned during the inter-war period how to use quantity and exchange controls with more precision than tariffs. Many special circumstances of the inter-war period involving post-World War I adjustments and the

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Restrictions, 1959.

18 This distinction may or may not be significant depending upon how often the tariff laws are changed, how the tariff laws are written, and how much discretionary decisions by customs officials affect the application of the tariff to the various commodities concerned.

19 Kindleberger notes in addition, under most of the traditional limiting assumption, what he calls the consumption effect, redistribution effect, terms-of-trade effect, and income (or employment) effect.

world-wide depression created some new objectives of commercial policies which required more precision than tariffs afforded.[20]

Many of the problems of the inter-war period have receded far into the background, while the problems of development of underdeveloped countries have come to the fore as an influence on international trading relations. With promotion of development an increasingly important consideration in the commercial policy decisions of underdeveloped countries following World War II, there has been increasing reliance upon quantitative and exchange controls in preference to tariffs. This has been the tendency in spite of the fact that most of the underdeveloped countries are members of the International Monetary Fund (IMF) and/or the General Agreement on Tariffs and Trade (GATT). Both organizations, in their policy statements, include agreement in principle on the desirability of a gradual reduction of all controls on international trade, and reliance on tariffs as opposed to quantity or exchange controls when control is deemed necessary.

When promoting development is recognized as the principal economic objective in underdeveloped countries, it becomes not just another purpose of commercial policy on a par with revenue, protection, and balance of payments considerations. It becomes the objective. Logical consistency then requires that commercial policy decisions to obtain revenue, protect domestic producers and protect the balance of payments be integrated with commercial policy to encourage development.[21]

International Economics, chaps. 12 & 13.

20 See M. S. Gordan, op. cit., chap. 1, et passim.

21 The consistency of approach in commercial policy formulation implied here has not yet been adopted. Nevertheless, the general development

The Significance of a Shift in Emphasis

There has been a tendency to equate the exercise of commercial policies with restriction of trade, and more especially with restriction of the volume of trade.[22] While commercial policies do place restrictions on acts of trade, their use for development in underdeveloped countries has a much broader orientation than "restrictionism" in the traditional sense that implies an ultimate result of a smaller volume of foreign trade.

For development, control over the type of trade is the primary consideration rather than the restriction of volume of trade that has traditionally been identified with commercial policies for protection. An increased volume of trade is of prime importance to rapid development in underdeveloped countries. Their production levels, especially of capital equipment, are low. An expanded, and expanding, volume of exports would mean increased foreign exchange earnings and increased access to the capital goods output in advanced countries. Due to the inadequacy of sources for the financing of planned development programs, expenditures of foreign exchange as a proportion of the total cost of such programs are significant.[23]

One of the identifying characteristics of underdeveloped economies is the concentration of exchange activities in foreign trade and related

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objective has loomed ever larger in the background against which commercial policy decisions in response to more immediately pressing (e.g. payment) problems have been made in underdeveloped countries. See the discussions of commercial policy developments and the contributing influences in the various annual issues of the Economic Survey of either Latin America or Asia and the Far East.

22 See Towle, op. cit., pp. 333, 425f, and 628.

23 Foreign exchange needs have been estimated at about one-fourth

sectors.[24] While development would be expected to reduce this foreign trade orientation of their economies through diversification and enlargement of the domestic sectors, the reduction would result from less relative importance of foreign trade rather than a reduced absolute volume. Commercial policies designed to encourage exports, foreign investment and money-capital imports would increase both foreign exchange earnings and the absolute volume of foreign trade.

DEVELOPMENT OBJECTIVES[25] TO BE FURTHERED BY COMMERCIAL POLICY

Increased productivity of human effort is the prime prerequisite

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of the total public and private cost of India's Second Five Year Plan and about one-half of the Philippine Five-Year Economic Development Programme. See Planning Commission, Government of India, The New India, Macmillan, N. Y., 1958, p. 145, and United Nations, "Economic Development and Planning in Asia and the Far East," Economic Bulletin for Asia and the Far East, Vol. VII, Nov. 1956, p. 54.

24 See United Nations, Measures for the Economic Development of Under-Developed Countries, p. 71.

25 The literature on economic development has mushroomed in the last ten years and many development problems and objectives have been analyzed, documented. Two excellent recent surveys are Meier and Baldwin, Economic Development, 1956, esp. Part 3, and Kindleberger, Economic Development, 1958. Already classics of a sort are Nurkse's, Problems of Capital Formation in Underdeveloped Countries, 1953; W. A. Lewis' The Theory of Economic Growth, 1955; and the United Nations studies Measures for the Economic Development of Under-Developed Countries, 1951, and The Economic Development of Latin America and Its Principal Problems (Prebisch), 1950.

A wealth of material is available in other occasional studies published by the United Nation's Economic Commission for Asia and the Far East and Economic Commission for Latin America. Economic surveys published by the International Bank for Reconstruction and Development are available on Ceylon, Colombia, Iraq, Malaya, and Nigeria among others.

Much of the development material is in article form. The University of Chicago has published since 1952 a journal, Economic Development and Cultural Change, devoted specifically to this general topic. The Economic Bulletins for Asia and the Far East and for Latin America contain articles on the subject of development. In addition, almost every issue of the various professional journals now contains an article or more on various aspects of development.

for improved economic wellbeing. Other development objectives relate directly to this basic requirement and include: (1) improvement in the quality of human effort, (2) accumulation of capital, (3) structural change in the economy, involving reallocation of existing resources and change in the pattern of resources, (4) expansion of the exchange economy, and (5) improved technology.

The impoverished populations of the underdeveloped countries are largely illiterate and untrained and debilitated by malnutrition and disease. For improved quality of human effort, the development needs implied constitute a part of what has become known as "social overhead capital," i.e., education and training, health services, and the necessary construction for shelter. Financing is the principal problem in creating social capital, and government revenues can be most efficiently raised in the exchange sectors of underdeveloped economies. Since the foreign trade sector is a significant exchange sector, the revenue raising potential of tariffs can provide direct commercial policy assistance in the creation of social capital for improving the quality of human effort.

Social overhead capital includes more than facilities for improving the quality of human effort. In its other forms--transportation and communication facilities, power facilities, and irrigation projects--social capital represents the infra-structure, creation of which in the underdeveloped countries is expected to be primarily a government function. For creation of these facilities too, commercial policy can provide assistance through the revenue raising potential of tariffs. In addition, priority allocation of foreign exchange to government can

assure procurement of necessary equipment obtainable only from abroad.

The social capital infra-structure provides conditions in which more pecuniary external economies of investment will be reflected in market prices.[26] Thus, private investment in venture capital is stimulated, and diversification of economic activity is encouraged. Accumulation of capital of all types in all sectors increases labor productivity by reducing the labor/capital ratio.

Larger volumes of saving and investment are required for increased capital formation. Due to inadequacies of market development and the prevalence of subsistence production in underdeveloped countries, much of the saving and investment that does occur is in kind.[27] Yet, saving and investment can be encouraged through commercial policy influences in existing markets. Foreign trade subsidies can increase private protection for internal producers, and exchange controls can do both.

An alternative source of saving and investment may be found abroad in the higher income countries with their greater savings potential. To some extent, policies that encourage private domestic investment will also attract foreign investors. Yet in some aspects, different policies are needed to encourage the latter, e.g., exchange regulations favorable to repatriation of funds and remittance of earnings.

Structural changes in underdeveloped economies involving a reallo-

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26 For discussion of pecuniary external economies, see above, pp. 27f.

27 Due to its nature, the extent of saving and investment in kind is not susceptible to accurate measurement. It is most likely to be a feature of the agricultural sector of the economy. The government of India, in the community development projects it has sponsored, has attempted to take advantage of this potential. See Planning Commission, Government of India, The New India, p. 176.

cation of existing resources and a changed pattern of resources can be designed to increase the marginal and average productivity of labor. Commercial policies to promote capital formation can be formulated to encourage such structural changes.

The need for expansion of the exchange economy within underdeveloped countries[28] is implied in the foregoing discussion of other development objectives. Division of labor and specialization of function make possible an increase in the productivity of human effort and are dependent on the size of the market, i.e., on the degree to which economic activity has been caught up in a system of exchange. Improvement in transportation and communication tends to enlarge exchange areas, as does diversified capital formation and structural change. On the other hand, expansion and refinement of markets will stimulate economic diversification and factor mobility. While commercial policies cannot lead to enlargement of the exchange economy directly, it may do so through influences on other objectives.

A serious deficiency in underdeveloped countries is the retarded state of technology.[29] There is open to underdeveloped countries a substitute for independent technological advancement in the form of imitation of production techniques, old or new, already developed in the advanced countries. This might be called the demonstration effect on

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28 See Morton R. Solomon, "The Structure of the Market in Undeveloped Economies", The Quarterly Journal of Economics, LXII, August, 1948, pp. 519-537. Reprinted in Underdeveloped Areas (L. W. Shannon, ed.), Harper, N. Y., 1957, pp. 131-140.

29 Some writers have given this a position of importance next to or ahead of capital formation. See Kindleberger, Economic Development, p. 76, for instances.

the production side. Allocation of foreign exchange to encourage imports of the latest machines and equipment can further this imitation process.

Natural resource conditions are related to technology with respect to discovery and availability. Rapid development is made easier the larger and more varied the supply of natural resources suitable for use in both primary and secondary productive activity. Lack of varied, adequate supplies of natural resources, however, should not preclude development, for many of any such deficiencies may be overcome through importation from abroad.

COMMERCIAL POLICY OBJECTIVES IN FURTHERANCE OF THE DEVELOPMENT OBJECTIVES

Commercial policies to promote development are appropriate, and sometimes imperative, at the point where each of the development objectives is related to foreign markets. The problem of capital accumulation, in its various aspects, is the one that most often relates to foreign markets. Commercial policies may be centered on this broad objective.[30]

Capital formation may stem from government investment, private domestic investment, or private investment from abroad. Capital goods producing industries are few and their production totals negligible in the underdeveloped countries.[31] The bulk of real capital for expanded public projects and private enterprises may have to be imported,[32] al-

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30 All of the development needs are interrelated. There is no intention to ignore or low-rate, for example, the need for improved technology or expansion of the exchange economy. Most policies that promote capital formation will also tend to promote the others.

31 See Solomon, op. cit., p. 138. Of course, this varies somewhat from country to country.

32 Nurkse points out that this has not been the normal state of affairs, op. cit., p. 113.

though reliance on capital imports may be reduced as appropriate capital goods producing industries are developed.

Increasing the Foreign Exchange Available

Significant proportions of total development program outlays for capital formation must be financed by foreign exchange earnings.[33] Commercial policy measures to promote an increase in the availability of foreign exchange can assist the financing of development programs. These measures can be directed toward increasing the volume of exports of merchandise or invisibles already being exported or toward creation of new export enterprises. Foreign exchange availabilities may also be increased by commercial policies to encourage investment by foreigners, to prevent capital flights, and to improve the terms of trade. Priority allocation of foreign exchange in general, and scarce currencies in particular, can assure exchange for the importation of capital goods required for development projects.

Obtaining Government Revenue

Commercial policy measures for increasing the foreign exchange available for capital imports can be used to promote accumulation of capital of any type. On the other hand, some commercial policy measures can be of particular assistance in the promotion of accumulation of capital of particular types. For example, public investment for the creation of social overhead capital requires financing. The government revenue possibilities in control of foreign trade can be used to stimulate social

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33 See above, p. 59.

capital formation. In the underdeveloped countries, foreign trade activities provide a convenient base for collection of government revenue, and revenues from this source are a significant proportion of total government receipts.[34]

While commercial policy measures that reduce imports and exports cannot at the same time increase revenues, commercial policies to control the pattern of imports and exports do not necessarily conflict with revenue collection in the same way. Furthermore, to the extent that collection of government revenue reduces private consumption relative to income and is then used for capital creation, the people of the country are forced to save, and investment of the savings is insured. In that process, direct government action is substituted for indirect promotion of development. Governments can use their revenue to promote development indirectly by providing subsidies to private enterprises.

Protection of Internal Producers

Private domestic investment can be encouraged by making domestic investment more profitable through protection from foreign competition. The fact that protection can encourage private enterprise, investment, and capital formation is not disputed. Even the fact that protection is justified in the case of industries that can eventually become competitive

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34 See Table 14.3 in Meier and Baldwin, op. cit., p. 302. This table shows the major components of government tax revenue in selected countries. For the "poor" countries customs receipts alone, i. e., not including revenue collections of other types from foreign trade controls, as a percent of total receipts range from only a small fraction for Turkey (1953) to about 75 percent for Haiti (1954). For most of the countries listed this percentage range is from about 10 percent to over 50 percent. The source for this table is Table 166 in the United Nations Statistical Yearbook for 1955.

without continued aid is not disputed. The question that is raised by free trade advocates is: for which industries and enterprises can protection be justified economically? Detailed consideration of this question was declared outside the scope of this study,[35] but unwise decisions in this regard can retard economic development rather than promote it. Consequently, evaluation of some of the actual decisions of this nature made in the commercial policies of underdeveloped countries is included in Chapter 5 in terms of the effect of those decisions on the achievement of development needs.

Allocation of Foreign Exchange for Development

If commercial policy controls are to influence economic activity into new development directions, a system of priorities for imports must be established. Regardless of the commercial policy instruments

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35 p. 30, above. A recent analytical approach to the general problem of programming development, which necessarily includes in its considerations issues involved in the question raised here, utilizes the tools of linear-programming. See H. B. Chenery, op. cit., pp. 60-72. For a more elaborate model, see Chenery and K. Kretschmer, "Resource Allocation for Economic Development", Econometrica, October, 1956, and Chenery, "The Role of Industrialization in Development Programs", American Economic Review, May 1955. See, also, A. E. Kahn, "Investment Criteria in Development Programs", Quarterly Journal of Economics, February, 1951, pp. 38-61, and J. Tinbergen, The Design of Development, 1956.

While the linear programming approach has much to offer in guiding investigation and in demanding more systematic and careful decision making, if it is used too literally or rigidly as a basis for policy, it could prove misleading. With specific reference to development of underdeveloped countries, one serious drawback of this approach is its reliance on existing resource, technical, and price conditions which may not be appropriate even by the time the analysis has been completed. For a discussion of the limitations of this and similar methods, especially for prediction and policy-making, see S. Schoeffler, op. cit., chap. 3, especially pp. 26-28 and 39-41.

used, i. e., tariffs and subsidies, quantity controls, or exchange controls, import priorities constitute a system for the allocation of available foreign exchange. The need for allocation of foreign exchange stems from the balance of payments position by which countries seeking rapid development find themselves confronted. Their development needs in terms of plant and equipment, spare parts, and raw materials, as well as consumption goods necessary to maintain even the low levels of living already attained, are excessive. Their production levels of both capital and consumption goods are very low. Therefore, the amount of foreign exchange available to them can be an important limiting factor on their rate of development.

Protecting the Balance of Payments

A corollary of the excessive demand for foreign goods is a tendency toward a continuing balance of payments deficit during the process of development. This tendency will be greater, the faster the rate of development attempted. The more successful are the development attempts in the early stages, the sooner the balance of payments pressures will be reduced, but also, the more imperative is careful husbanding of foreign exchange earnings in the early stages of development. Foreign exchange allocation is practiced by all of the underdeveloped countries whose governments have moved to pursue deliberate development. Imports have been classified into categories as to their essentiality for development and maintenance of living levels, for the purpose of encouraging the more essential, reducing the less essential, and preventing the

non-essential.[36]

Controlling the Effects of Inflation

Another factor affecting the balance of payments is the inflationary tendency that is a common feature of early stages of attempts to develop. The early investment or government expenditures generate income which is nearly all spent on consumption due to the low levels of income being received. At the same time, production of consumption goods is not increasing due to the time lag in the productive process.

Balance of payments difficulties are aggravated by inflation, for higher prices tend to reduce exports and increase the demand for imports. This is another reason for emphasis on increased foreign exchange earnings and priority allocation of foreign exchange. It is also a reason for including imports of consumption goods, especially necessities or those for which demand is inelastic, in the "essentials" category. Assurance of supplies of necessity consumption goods can constitute a commercial policy contribution to combating inflation.

Influencing the Terms of Trade

Finally, commercial policies may assist development by helping maintain or improve the terms of trade for underdeveloped countries. Most underdeveloped countries export relatively few primary commodities. The prices of their primary goods exports fluctuate widely in relation to relatively stable prices for the manufactured goods which form the bulk of their imports. This has meant wide fluctuations in their terms of

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36 The meaning of "essential" in import priorities as established by underdeveloped countries is discussed below, p. 134.

trade with the predominant tendency on the unfavorable side.

In the past, wide fluctuations, related to trade cycles, have occurred in the world demand for the exports of underdeveloped countries. This fluctuation of demand has tended to disrupt their development programs and cause their commercial policy decisions to be made in response to balance of payments emergencies. One of the principal difficulties is that commercial policy measures to combat such emergencies, e. g., restriction of imports, may be as disruptive of development plans as are the fluctuations in the terms of trade.

Most underdeveloped countries lack the monopoly position in their export markets necessary to command higher prices and force improvement in their terms of trade. A more effective long-run approach to the problem of fluctuations in their terms of trade is the encouragement of new export industries.

CHAPTER IV

THEORETICAL ANALYSIS OF THE USE OF COMMERCIAL POLICIES FOR DEVELOPMENT

This chapter is devoted to theoretical analysis of the capabilities of specific commercial policy techniques for furthering development objectives. As indicated in the introductory chapter, our primary concern is with how commercial policies can be used in pursuit of various development ends, rather than with which specific ends to pursue.[1] For example, how can commercial policies promote new enterprises? Not, which new enterprises should be promoted?

Much of the GATT analysis, already frequently referred to, deals with whether it would be best to encourage primary-goods exports or processed-goods exports in view of their relative earnings potentials. Or, should export industries with foreign-exchange-earning capacity be encouraged in preference to import-competing industries with foreign-exchange-saving capacity?[2] The present study touches on these aspects of economic policy only as it is necessary forcomparative analysis of the effectiveness of the various commercial policy instruments for promoting development.

The analysis is oriented around the question of what can be done with the commercial policy instruments--tariffs and foreign trade subsidies, quantitative controls, and exchange controls--to assist in achievement of both the major and minor commercial policy objectives of development set

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1 See p. 1 above.

2 See the United Nations, Economic Bulletin for Asia and the Far East, VIII, 1, May, 1957, pp. 8-17.

forth in the preceding chapter. It is important to remember that almost anything that can be done with one broad category of commercial policy instruments can also be accomplished, either more or less effectively, with some variant of either of the other broad categories of commercial policy instruments.

A simple analogy may serve to clarify this point and the purpose of the present analysis. Wrenches, pliers, hammers, crowbars, etc. are all tools designed to perform different basic functions, yet for a wide variety of purposes they are interchangeable with varying degrees of efficiency. Similar functional interchangeability is characteristic also of commercial policy instruments. The present analysis distinguishes some more appropriate basic functions for each of the commercial policy instruments in furthering development objectives. This involves consideration of the nature of their interchangeability. Empirical study of the success and effects of such development uses of commercial policy instruments is reserved for the next chapter.

TARIFFS AND FOREIGN TRADE SUBSIDIES

Non-discriminatory Tariffs

A non-discriminatory import tariff, i. e., the same rate of ad valorem duty applied to all imports, can be eliminated from consideration as a worthwhile commercial policy device for stimulating development, even as a means of raising government revenue. The reason is that while such a tariff is non-discriminatory, in the sense of involving no deliberate discriminatory decisions, it would not be without its differential effects on the various import commodities due to their differing elasticities of de-

mand and supply. Since differential effects cannot be avoided in a tariff levy, they should be taken cognizance of to the extent possible.

Policy should be deliberately selective of the effects to be encouraged rather than allowing them to be of an indiscriminate nature. Whether a non-discriminatory import duty is levied at a relatively low rate for primarily revenue purposes or at a relatively high rate for prohibitive purposes, its indiscriminate effects make it an inefficient means of influencing the availabilities and allocation of foreign exchange, the balance of payments, inflationary forces, and the terms of trade. The same may be said of a non-discriminatory export duty.

Discriminatory Import Tariffs

Import Tariffs for Revenue. Much more efficient than a non-discriminatory tariff system for influencing development objectives are tariffs which discriminate by type of product and/or country of origin or destination. However, development use of deliberately discriminatory tariffs is influenced significantly by two elements. The first element is the point made earlier about the uncertainty of the price and cost, and more especially, the quantity effects of tariffs.[3] The second is the paucity of government revenue sources in underdeveloped countries.

In view of the latter point as well as of the relative administrative ease involved in tariff collection, customs duties may be expected to continue as an important source of government revenue in most underdeveloped countries, at least in their early stages of development.[4]

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3 See above pp. 44f.
4 See Buchanan and Ellis, op. cit., Table 15-2, p. 327.

Historically, tariffs have been an important early revenue source for most countries.

Yet, a discriminatory tariff, even though levied primarily for revenue purposes, may be made to contribute to achievement of some of the other development objectives. For example, to be successful as a revenue raiser, a tariff on imports must leave the total volume of imports of the commodities on which it is levied relatively undiminished. Therefore, it must be applied primarily to commodities for which demand is relatively price-inelastic, i.e., physiological or psychological necessities. Revenue from such a tariff would come primarily from funds which would otherwise be spent on consumption and, to this extent, would constitute forced savings. Total savings would be increased thereby to the extent that the government used its revenue for investment rather than for current expenditures.

Additionally, import duties for revenue which discriminated among broad categories of imports with low rates on essentials, intermediate rates on semi-essentials, and highest rates on non-essentials[5] would incorporate some control over the pattern of imports with the raising of revenue. Also, while even a low tariff rate on essentials would not encourage the importation of essentials directly, the greater restrict-

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5 The categorizing of imports on the basis of "essentiality" has tended to follow similar patterns in the various underdeveloped countries. "Essential" imports have usually included capital goods for industry and agriculture and raw materials for development of new industries, as well as consumption necessities. Imports classed as non-essential have usually reflected considerations of encouraging domestic enterprise as well as "luxury" considerations. More detailed information on such import classifications is presented in the following chapter.

iveness of a higher rate on non-essentials would constitute a backhanded allocation of foreign exchange to the importation of essentials.

The higher duty rates on semi-essentials and non-essentials, if not entirely prohibitive, would tend to introduce some degree of progressivity into the customs portion of the tax system. In this regard, the demand for luxuries on the part of the wealthy elite may be relatively price inelastic.[6] However, other revenue sources--e.g., income and property taxation--could provide a more effective means of introducing progressivity into the governmental revenue system.

Whether such a tariff structure would also result in increased private saving is highly speculative. Due to the probably one-hundred per cent propensities to consume on the part of the low income bulk of the population,[7] any significant increase in private saving that resulted would have to come from the small percent of wealthy. The tariff would have to result in reduced imports of semi- or non-essential commodities without thereby stimulating domestic production of commodities of the same type. The possibility of an undersirable diversion of resources to production of luxuries has been one of the criticisms of a policy of restriction of luxury imports.[8]

Whether such diversion would occur would depend upon what particular luxury commodities were restricted from importation, and what the

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6 See R. E. Schlesinger, Multiple Exchange Rates and Economic Development, 1952, pp. 10f.

7 See United Nations, "Taxation and Economic Development in Asian Countries," Economic Bulletin for Asia and the Far East, IV, 3, November, 1953, p. 1.

8 This possibility has become so widely accepted as to be cited in most international economics textbooks. See for example, Towle, op. cit., p. 840.

internal production possibilities for these commodities were. Greater assurance that luxury restriction would lead to private saving would require other influences which tariffs are relatively less capable of exerting, e.g., control over money capital movements to prevent capital flights and internal controls over the use of resources to prevent the diversions which might slow development.

Nevertheless, some protection of internal production of the commodities affected is inherent in an import tariff levy, even if the primary purpose is to raise revenue. The degree of protection is less the lower the tariff rate, the smaller the change in import prices and the smaller the reduction in the volume of imports. Since changes in import prices and quantities are dependent on the price-elasticities of demand for the commodities affected, the protective effects of tariffs are uncertain. This is particularly true in the economies of underdeveloped countries with inadequately developed domestic markets and structural rigidities, especially factor immobilities.[9]

Taken together, the uncertainties as to the price, cost, and quantity effects of tariffs and the paucity of government revenue sources in underdeveloped countries favor a commercial policy decision to reserve tariffs for the primary function of raising revenue. This is not to imply that other revenue sources, as they can be expanded, might not be more desirable on most counts such as equity, effects on incentive, and stability of revenue.[10]

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9 See above, p. 45.

10 See, for example, United Nations, "Taxation and Economic Development in Asian Countries," Economic Bulletin for Asia and the Far East,

Rather, the revenue potential is the most important contribution that tariffs as commercial policy can make to economic development. In view of the fluctuations in tariff revenue that have resulted from essentially short-period cyclical fluctuations in exports and imports,[11] the revenue contribution of tariffs would be even more important if exports could be diversified so as to provide a higher, more stable level of exports, and thus also of imports, as a base for revenue-tariff levies.

Import Tariffs for Protection. While import tariffs can be, and are, used for protection of internal production, import quotas are more effective for this purpose.[12] With either a tariff or a quota, the assistance to internal production is expected to derive from a higher price in the domestic market resulting from reduced domestic-market supply of the restricted commodity. The degree of such protection depends on (1) the magnitude of the reduction in the quantity of imports, as well as on (2) the effect of the import reduction on the domestic-market price.

The price effect of a given reduction in imports depends on the elasticity of domestic demand for the restricted commodity irrespective of whether the reduction is achieved by means of a tariff levy or the imposition of an import quota. However, the size of the import reduction resulting from the levy of a particular tariff rate is more uncertain

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IV, 3. November, 1953, pp. 1-15.

11 Ibid., p. 5.

12 More thorough analysis of commercial policy for protection is deferred to the section on import quotas. See below, pp. 90ff.

than that resulting from the use of a quota. This is true because the restrictiveness of a tariff depends on the elasticities of foreign supply and of domestic demand for the commodity upon which the tariff is levied. The restrictiveness of an import quota, on the other hand, is not dependent on either of these elasticities.

Furthermore, there is a practical-policy consideration in underdeveloped countries which favors tariffs for revenue rather than for protection. Data concerning government revenue is more readily available and more accurate than data concerning prices or private-individual and enterprise-reactions to price changes. Thus, while for theoretical precision the knowledge needed for successful tariff policy for revenue and for portection is the same, as a practical matter, tariffs for revenue can be more accurately adjusted to achieve desired results than can tariffs for protection.

Import Tariffs and Foreign Exchange Availabilities. Efforts to increase the foreign exchange available for development needs may take the form of increasing the total supply of foreign exchange or increasing foreign exchange, net, for specifically development uses. Increasing exports is the most direct path to increasing foreign exchange proceeds, although substitution of domestic output for imports will increase foreign exchange earnings, net.

Discriminatory import tariffs may be levied to protect only enterprises that compete with imports for the domestic market, or enterprises with export possibilities as well. In view of the small domestic markets in underdeveloped countries, enterprises with export possibil-

ities may be easier to promote.[13] However, weaknesses of tariffs for protection as compared with import quotas were pointed out in the preceding section. Furthermore, general production subsidies or other commercial policy instruments, e.g., favorable exchange rates under a multiple rate system or export subsidies, can provide more positive assistance to desired enterprises.

Increasing foreign exchange earnings, however, relates only to the supply side of the broader objective of increasing foreign exchange availabilities for development. Allocation of foreign exchange to development needs represents the demand side. Foreign exchange allocation for furthering development involves control over the pattern of imports such that goods deemed most essential to the development process are given top import-priority. The nature of the assistance in controlling the pattern of imports that might be obtained from discriminatory import duties was suggested above.[14]

Import tariffs could accomplish much more in allocating foreign exchange for development, than was suggested earlier, if it were decided that this objective were to be the dominant consideration in structuring the tariff system. With a more detailed classification of imports and more restrictive (higher) import tariffs on a wider range of individual commodities, foreign exchange could be more stringently conserved for development purposes.

However, the use of tariffs for allocating foreign exchange is a

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13 For elaboration of this point, see below, pp. 86ff.
14 See pp. 72f.

relatively indirect approach.[15] A much more direct approach would be the use of exchange controls.

Other Commercial Policy Objectives. Tariffs also have little to contribute in influencing money capital movements or "invisibles" transactions on current account.[16] About the only aid tariffs could give in regard to money capital flows would be as the creation of enterprises under protective tariffs involved investments by foreigners.[17] The control over invisible transactions and capital movements which exchange controls provide is one of the basic advantages of exchange controls as one alternative set of commercial policy instruments.

The balance-of-payments deficits which tend to plague underdeveloped countries bent on development represent both long-period and short-period problems. The persistence of balance of payments deficits[18] constitutes a continuing problem over the long run, but this condition is aggravated by a tendency toward recurrent, short-period crises in the balance of payments.[19] For protecting the balance of payments during crises or over the long period, tariffs are less effective than other commercial policy instruments.

Balance of payments deficits must be eliminated either by restrict-

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15 On the advantages of "direct" versus "indirect" interference with market forces, with special reference to the situation of underdeveloped countries, see the discussion of quantitative controls below, pp. 93f.

16 For a classification of these items see the Annex to the International Monetary Fund, Third Annual Report on Exchange Restrictions, Washington, 1952.

17 Analysis of commercial policy to encourage investment by both nationals and foreigners is elaborated below, pp. 90f.

18 See below, pp. 92ff.

19 See below, p. 100.

ing imports or by increasing foreign exchange proceeds. Since import restriction as a long-run policy would retard development, the most promising approach to solution of the long-run balance of payments problem lies in increasing foreign exchange availabilities. The weaknesses of import tariffs relative to other commercial policy instruments for increasing foreign exchange availabilities were pointed out in the preceding section.

The recurrent payments crises of underdeveloped countries stem from fluctuations in both the volume and prices of their primary goods exports[20] unaccompanied by similar fluctuations in their import needs or the prices they must pay. Thus the short-period payments problem requires temporary, but often drastic, reductions in imports. The greater administrative inflexibility and less precise quantitative effects of import tariffs relative to import quotas[21] means that tariffs are less effective than quotas in protecting the balance of payments during short period deficits.

To the extent that the balance of payments crises are related specifically to fluctuations in the terms of trade, i.e., a reduced ratio of export prices to import prices, again tariffs are an ineffectual remedy. For import tariffs to improve the terms of trade, the foreign suppliers must be forced to bear the burden through a reduced price. This would require that the foreign exporters' supply be a significantly large portion of the exporters' market. Since most of the imports of underdeveloped countries are manufactured products, neither of these

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20 See below, p. 124.
21 See above, p. 45.

conditions tend to be met in their situation.

With respect to a related development objective, that of buying imports as cheaply as possible, the GATT analysis takes a different tack. They suggest[22] that if it is deemed necessary for purposes of development to interfere with foreign trade, interference by tariff would at least permit importers to buy in the market or country where they could buy cheapest. This is an objection to practices which channel trade on a bilateral basis, an issue which is excluded from primary consideration in this study.

While multilateralism would further the cause of development in underdeveloped countries, especially if promoted on the initiative of surplus, i. e., hard currency, countries in removing their balance of payments surpluses, even tariffs could be formulated to conflict with multilateralism. Other commercial policies, e. g., multiple exchange rates, could be formulated so as to allow the same freedom of market access for importers as that which the GATT suggests is allowed by tariffs.

Discriminatory Export Tariffs

Export tariffs are relatively ineffectual for furthering most of the development objectives.

By nature, export duties work to the disadvantage of internal producers. Yet export duties that discriminate, through higher rates, against exportation of primary commodities can encourage enterprises to process those commodities either for domestic or export markets. Whether the selective promotion of export enterprises involved would on balance further the

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22 Op. cit., p. 13.

development process, would depend upon whether in the changed pattern of exports the new export commodities faced a more favorable, stronger world market than did the primary commodity exports being discouraged. To assure furtherance of the development process, careful appraisal of potential exports and their prospective markets, followed by continual reviews of the findings and results, would be necessary.[23]

The results of such a policy, if successful, would be increased foreign exchange earnings which are an important avenue to increased availability of foreign exchange for development. Whatever the potential benefits from such selective promotion of export enterprises, however, other commercial policy instruments are capable of giving more positive and effective assistance in encouraging the export enterprises selected for promotion. This would be true either of direct export subsidies or indirect subsidies built into a system of exchange controls.

In view of the fact that export duties in their applicability are limited to transactions involving tangibles, they can influence money capital flows hardly at all. Any influence along these lines would have to be exerted through effective encouragement of foreign investment in favored enterprises. By the same token, export duties can accomplish little in the way of conserving foreign exchange, "scarce" or convertible.

Furthermore, export tariffs affect the wrong side of the market for having any concerted effect upon the pattern of imports or, therefore, for encouraging the importation of essentials. If export duties should

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23 Ibid., p. 16.

reduce the overall level of exports, they would also make it difficult to maintain the overall level of imports.

Attempts to influence the terms of trade by means of export duties would tend to reduce the overall level of foreign trade. To improve the terms of trade via the export side requires making the foreign customer bear the burden of the export duty by paying a higher price. Similarly to the situation necessary for an import tariff to improve the terms of trade, the foreign buyers' demand for the dutiable export commodity would have to be relatively inelastic and the exports of the country levying the duty would have to be a significant proportion of the total world supply of the dutiable export. The danger of attempting to exploit such a situation when it does exist, is that alternative sources of supply, either natural or synthetic, may be cultivated eventually by foreign customers, thus undermining the long-run export potential of the duty levying country.

Actually, however, the markets for most primary product exports of underdeveloped countries have been marked by relatively unstable conditions of extreme competition, rather than by exploitable monopolistic conditions. This has been an important reason why international commodity agreements have frequently been resorted to in an effort to make primary commodity prices more stable through unified action.

Export Duties For Revenue. In view of the relative ineffectiveness of export duties for achieving the other development objectives, they can contribute most to development if they, like import duties, are reserved for raising government revenue. Since foreign exchange proceeds are so important in financing any development program in underdeveloped

countries, the relatively lower rates that would tend to characterize export duties for revenue make reservation of export tariffs largely for revenue even more advisable than a similar policy for import tariffs.

Whether export duties should be used at all, even for revenue, would depend upon whether their possible adverse effects on the volume of exports, or more importantly upon foreign exchange earnings, were so great as to outweigh the advantages that might be gained from judicious use of the government revenues which they would provide. However, as in the case of import tariffs, paucity of alternative revenue sources in underdeveloped countries makes probable the use of export duties for revenue for some time to come.

Underdeveloped countries have found export tariffs of particular assistance in capturing for domestic use a larger portion of the proceeds of existing foreign owned export enterprises. As Kindleberger points out,[24] any revenue collected from foreign owned enterprises increases domestic national income, and this could be a source of net enlargement of funds available for promoting development. This aspect is the soundest basis for constructing the discriminatory features of a system of export duties. Other bases for discriminatory export duty rates are less numerous than for import duties, at least in the early stages of development, due to the greater uniformity in the general nature of exports of underdeveloped countries.

Import Subsidies

From a revenue point of view, subsidies are the exact opposite of

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24 Economic Development, p. 269.

tariffs. Rather than providing a means of raising revenue, they are a drain on the government's financial resources. For promoting a number of other development objectives, however, import and export subsidies, and, for "protection", general production subsidies are nearly perfect substitutes for tariffs. For many uses, the principal limitation on such substitution in underdeveloped countries is the inadequacy of government revenues.

For a long time, general production subsidies have been advocated by economists, especially Western economists, as a substitute for protective import tariffs.[25] As a practical matter, especially in Western countries, this proposal has tended to be politically unrealistic due, in considerable degree, to the opposition of the recipients themselves to receiving their aid in such a direct and obvious form. In view of the more favorable attitude toward a larger economic role for government, this objection might be less of a drawback for such a policy in most underdeveloped countries than in the West. Even so, the primary concern of this study is not with general production subsidies, but with foreign trade subsidies.

Import subsidies may have some advantages over production subsidies as an instrument for promotion of internal production, although not in the form of "protection". Selective import subsidies can encourage the importation of goods that are unavailable internally yet considered essential for development. Such a policy could provide a positive, although indirect, encouragement to investment by private enterprisers in industries that are deemed particularly desirable

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25 Towle, op. cit., p. 469.

from a development point of view.

By singling out for particular encouragement imports of goods in the fixed capital category, e.g., heavy machinery, initial investment could be encouraged in as wide a range of industries as could utilize the subsidized imports. This policy would have the advantage, over both protective tariffs and general production subsidies, of encouraging investment in fixed capital without providing a continuing margin for inefficient production and operation. While domestic markets might still be inadequate for this policy alone to be sufficient investment incentive, it would offset some of the advantages of established foreign industries.

For furthering other development objectives, import subsidies have little to offer except in side effects of the policy just described. Much the same effects as those described are possible of achievement through indirect subsidization of imports within a system of exchange controls. Furthermore, exchange rates favoring particular imports would provide a subsidy without incurring the costs of revenue collection and disbursement.

Export Subsidies

Export subsidies encourage exports by increasing the profit margin or lowering the export price on the particular export goods subsidized. A policy of subsidizing exports could be designed to diversify export enterprises so as to increase foreign exchange earnings and make possible an increased volume of imports. New industries should be selected for encouragement, since already existing export enterprises do not need sub-

sidies and the potential for primary commodity exports has already been largely tapped in most underdeveloped countries. New export industries, even those that involve processing of raw materials previously exported as raw materials, could produce for the domestic market as well.

To the extent that they prove successful in increasing export earnings, export subsidies have the advantage for the nation as a whole of providing a means for converting domestic currency, in which the subsidies are paid, into foreign exchange to meet the large foreign exchange needs of the development program. They would also tend to improve the balance of payments position, although the terms of trade might be worsened initially. Whether or not export subsidies were also inflationary would depend on how the subsidies were financed.

A potentially serious difficulty involved in a program of export subsidies for new industries relates to the relationships among underdeveloped countries. A significant proportion of the foreign trade of the underdeveloped countries is carried on with other underdeveloped countries in the same area,[26] and the proportion of new industry exports sold to other underdeveloped countries is even greater. In view of the fact that most of the underdeveloped countries are attempting to develop, export subsidies granted by one are likely to be viewed by the others as a form of dumping which will hamper their own efforts at development. Difficulties of this type are given particular attention in recent studies being conducted by the Latin American countries pursuant to efforts

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26 For example, in 1958, 26 per cent of the total foreign trade of the ECAFE countries, excluding Japan, was among themselves. This is figured from Table 7 in the Economic Bulletin for Asia and the Far East, X, 2,

to establish a Latin American common market.[27]

Since subsidies, like tariffs, require legislative action, and, like tariffs, operate through effects on prices, costs and profits, they tend to be subject to the same inflexibilities and uncertainty of effects as are tariffs. Furthermore, due to the drain of subsidies on government financial resources and the possibility that alternative commercial policy instruments are capable of furthering the same development objectives with either more precision, or flexibility, or both, subsidies are likely to be used only for promotion of enterprises or industries deemed especially worthy in terms of development needs.

QUANTITATIVE CONTROLS

For Revenue

The tax nature of tariffs fits them especially for raising government revenue. While it is possible to raise revenue with import or export quotas when they are established under a licensing system,[28] it requires a much more elaborate and costly administrative apparatus. Therefore, the net government revenue potential of quotas is less.

In addition, raising revenue by means of a quota licensing scheme complicates revenue collection unnecessarily. Two decisions--quota size and license fee--have to be made under quota licensing whether for revenue or other purposes. With tariffs for revenue, the tariff

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Sept., 1959, pp. 37-40.

27 See, for example, U. N., "The Latin American Regional Market", Economic Bulletin for Latin America, Vol. III, No. 1, March, 1958. pp. 1-8.

28 See above, p. 50.

rate is all that has to be decided. The volume of imports or exports fluctuates in response to price as influenced by the tariff.

It is possible to avoid the problem of fixing the license fee by auctioning quota licenses to the highest bidder. When the volume of imports is reduced by quotas, windfall profits tend to accrue to favored importers from increased value of the imports. Competitive auctioning of licenses can insure collection of the windfall profits by the government.

Furthermore, auctioning import licenses tends to reduce the corruption and bribery that is likely to accompany decree allocation of licenses. This can be a particularly serious problem in underdeveloped countries due to lack of an adequate number of experienced administrative officials with a tradition of faithful public service.

A helpful modification of quota-license auctioning is a foreign exchange auction market in which quantitative restrictions are combined with exchange controls. One advantage of exchange auctioning is that it permits use of the already existing institutions of the banking system and their personnel. Nevertheless, neither quota-license auctioning nor the exchange auction market have been widely used. One of the most serious objections to such systems has come from established foreign traders who fear competition from fly-by-night, low-overhead operators.[29]

The point is that quantitative controls even with quota licensing

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29 See, however, A. Kafka, "The Brazilian Exchange Auction System", Review of Economics and Statistics, Vol. XXXVIII, August, 1956, pp. 308-326.

are an inefficient means of raising government revenue. Their direct effect upon quantities imported or exported, however, make them a more certain and precise instrument than tariffs for control of the quantity of particular goods imported or exported when such control is deemed necessary or desirable for development. As noted in the preceding chapter, an additional element of precision and flexibility is introduced by quota licensing on a day-to-day basis.

Import Quotas

The major objectives of commercial policy for development that can be most directly attacked by the use of import quotas are protection of internal producers and protection of the balance of payments.

Protection and Inducement to Invest. The theoretical justification of protection of internal producers, at least in some cases, has long been recognized in the general acceptance of the "infant industry" argument. The justification is the assistance that domestic producers in underdeveloped economies need in order to overcome the initial cost advantages that already established enterprises in the advanced countries have, especially in industries that require large-scale production to achieve lowest per-unit-cost operation.

The inducement or assistance to creation of internal enterprises is the expected higher price in the domestic market that results from a reduced supply of the restricted commodity in the domestic market. The strength of the inducement, i.e., the degree of protection, depends on the size of the reduction in the quantity of imports and the elasticity of demand for the commodities affected. The size of the reduction

in the quantity of imports can be precise when import quotas are used for protection. The import reduction is uncertain when import tariffs are used.[30]

Thus, the use of import quotas for protection, as opposed to tariffs, eliminates one area of uncertainty. Furthermore, the greater administrative flexibility of an import quota system, as opposed to a tariff system,[31] makes possible a readier adjustment to resultant changes in price and production should original quotas provide inadequate protection to induce internal production. The weakness of any protective policy is that even complete prohibition of imports may not induce the desired investment.[32] Due to the low incomes in underdeveloped countries, even reserving the entire domestic demand for internal suppliers may not be sufficient to make investment profitable. Foreign suppliers often have an advantage in that their export markets in underdeveloped countries are only a small part of their total market.

Complete prohibition as protective policy would not be desirable in most cases. Enterprises first selected for promotion in a low-income economy need to be those producing for broad consumption, e.g., processed foods or textiles. Drastic cuts in imports of such goods would generate excessive inflationary pressures.[33]

Selection of broad-consumption industries for promotion under pro-

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30 See above, p. 45.
31 See above, p. 45.
32 This point is elaborated by Nurkse, op. cit., p. 105.
33 The intended implication of the word "excessive" is that some inflation may stimulate development. For an analysis of the relation between economic growth and inflation see F. Pazos, "Economic Development and Financial Stability", Staff Papers, International Monetary Fund,

tective import quotas has two advantages. First, these industries do not require heavy initial investment. Second, the products of such industries are imported by most underdeveloped countries in large volume and thus preempt significant portions of available foreign exchange. Creation of these industries and rapid expansion in their output early in the development process would combat inflation, ease pressure on the balance of payments and conserve foreign exchange for importation of capital goods.

There is another consideration that may influence the selection of enterprises to be promoted through protective policy. It would be helpful in inducing investment to have, for exploitation, a larger demand than is available in the domestic market alone. Export markets--possibly in other underdeveloped countries--might provide that larger demand. With the domestic market as a nucleus of demand, initially exporting the surplus could mean a larger scale of production, lower per unit cost, and greater profitability.

A final observation regarding protective policy is in order. The necessary savings out of which investment can come are more readily available in advanced countries than in underdeveloped countries. Actually protective policies to promote domestic investment could also stimulate foreign investment, and vice versa. With this fact in mind, careful selection of the imports to be restricted and permitted under import quotas could stimulate the establishment of "tariff factories"--possibly "quota" factories would be a more appropriate term here.

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vol. III, October, 1953, pp. 228ff.

Protecting the Balance of Payments. There is no more direct means for a country to eliminate a deficit in its balance of payments on current account than by restricting the quantity of imports. For this purpose, import quotas are much more certain than tariffs. Furthermore, emergency measures for protecting the balance of payments in a crisis are less likely to be disruptive of the development process if import restrictions are on a selective basis, and import quotas provide the greater precision and flexibility required for such a selective response to payments crises. The flexibility in application of import quotas is also especially helpful for quick action to meet the emergency, as well as for rapid removal of the stringent controls once the emergency is past. During payments emergencies, assurance of continued importation of "essentials" is of particular importance.

The objective of GATT is to eliminate all trade controls except tariffs and to subject tariffs to negotiated agreements. The rationale of that objective is that since they leave the price system free to guide private economic decisions, tariffs involve less "arbitrary" distortion of "normal" trade patterns than do other controls. Yet, "normal" trade patterns have not resulted in economic growth for the underdeveloped countries. Inadequately developed economic institutions, especially the market mechanism, have contributed to this failure.[34]

There is much to be said for price direction in an autonomously developing economy, and the price mechanism may be relied upon to a greater extent as autonomous development momentum is achieved. However,

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34 See above, pp. 23f.

there is a discrepancy between individual and social benefit derived from the various possible investments which tends to retard the development process when direction of economic activity is left exclusively to the price mechanism in an underdeveloped economy. Decisions that are most productive of private profit or private asset security are frequently not the decisions that are best for furthering development.[35]

In regard to the pattern of imports, the individual and social benefit discrepancy tends to be magnified during balance-of-payments crises. Assurance of continued importation of "essentials" requires the greater certainty of control that import quotas can provide. To the extent that import quotas can be administered with greater arbitrariness than tariffs, arbitrary withdrawal of quotas is easier once the need for protection of the balance of payments or of internal producers is past.

Other Commercial Policy Objectives. Regardless of the main objective, or objectives, any import quota system through its control over the volume and pattern of imports will affect the allocation of foreign exchange. By prohibiting or reducing importation of some commodities, available foreign exchange will tend to be automatically directed toward other imports, thus making it possible for import quotas to be used for conserving foreign exchange--either convertible or scarce currencies--for the importation of essentials. Restriction of imports from particular countries can incorporate conservation of scarce currencies in the import quota system. For these purposes import quotas

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35 See above, pp. 27f.

are more certain and precise than tariffs, but exchange controls combined with quantity licensing can provide more complete control over foreign exchange.

In formulation of import quota policy, it is important to keep in mind the protective nature of import restrictions whether the purpose of the restrictions is protection of internal production or not. The possible conflict of objective involved in this fact[36] requires a careful balancing of policy objectives and effects. This requirement assumes particular significance when economic development is recognized as a process involving continually changing conditions. Thus, for example, as development proceeds, if it does, it will be necessary continually to reorder the priority of goods for importation and for internal production. By the same token, the most advantageous priorities for each underdeveloped country at any particular time depend upon its particular circumstances and stage of development.

Export Quotas

Little direct assistance for development can be expected from export quotas. They can be used, however, in conjunction with other commercial policy instruments, to encourage diversification of exports by restricting the exportation of commodities in unprocessed form. In this fashion they can reinforce policies to encourage foreign and domestic investment in "tariff factories". As stated previously, diversification of exports can lead to improvement in the long-run terms of trade, and

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36 One aspect of such conflict has already been discussed in connection with possible undesirable diversion of domestic resources to production of luxuries. See above, p. 74.

thereby increase the foreign exchange earning potential of exports.

Most commonly, export quotas have been aimed at improving the terms of trade immediately by raising export price through reduced supply. Yet in most instances, underdeveloped countries have not possessed sufficient monopolistic power in the markets for their exports to make possible such control over price. In the relatively few cases where underdeveloped countries have had sufficient market power to improve the short-run terms of trade, foreign buyers have tended to develop alternative sources of the same commodities or synthetic substitutes.

Because of the prevalence of such unfavorable conditions or developments, the most promising contribution of any commercial policy to improvement in the terms of trade lies in furthering diversification of exports such that the shift is to exports in the production of which the marginal and average productivity of labor is higher. Because of the interconnectedness of objectives, this objective, like others, is more susceptible of fulfillment, the more successful are all policies in bringing about a changed pattern of resources, capital formation, enlargement of the exchange economy, etc., i.e., fulfillment of the broad development needs.

Summary

In view of the foregoing analysis, it would appear that the wisest course might be to reserve quantity controls, especially on imports, for assistance in meeting balance of payments crises and in protecting internal producers. Due to the greater certainty of the quantity effects of quotas, they are often essential in combating temporary crises in the

balance of payments. Their greater precision makes import quotas particularly helpful in the restriction or prohibiton of non-essential and semi-essential imports, designed both to protect the balance of payments and internal producers. In protecting internal producers, at least in the early stages, special emphasis should be placed on encouragement of low-initial-investment industries. In the long-run, the emphasis should be on diversification of exports and encouragement of foreign investments.

Underdeveloped countries are faced with a dilemma posed by the fact that economic development is by its very nature a continuing process over time, while their very low levels of development place them under great pressure to develop rapidly. It is in the context of this dilemma that quantity controls, i.e., quotas, have the greatest advantage over tariffs.

Quotas are especially capable of combating unfavorable emergency payments and trade conditions, yet, because of their greater flexibility of application, they can be more readily removed when no longer needed or desirable. Thus quotas are very helpful short-run expedients which can be more readily adjusted so as not to conflict with long-run development. Furthermore, this same flexibility in removal of quotas when they are no longer needed, makes them a more suitable means of providing protection to internal producers only so long as protection is necessary or desirable.

The analysis of quantitative controls has been presented largely in terms of import and export quotas, although quotas may be combined with exchange controls. When quotas are combined with exchange controls

they tend to lose their distinctive identity. For example, the quantity fixing involved in establishing a quota, when done in conjunction with exchange controls, is incorporated in a foreign exchange licensing system. Thus, the quantities of the various goods allowed to be imported are fixed by the decisions to issue, or not, licenses for the purchase of foreign exchange for importing designated goods. The effects of quantitative controls are the same whether implemented through quotas or foreign exchange licensing on a quantity-of-goods basis. It may be, however, that it can be more effectively administered in conjunction with exchange licensing.

EXCHANGE CONTROLS

Controls over foreign exchange as a means of influencing international trade have become extremely prevalent throughout the world in the postwar years. There are several reasons for such increased reliance on exchange controls as opposed to other commercial policy instruments. First, exchange controls may be operated largely within already existing administrative apparatus. The existing apparatus is the central bank which most independent underdeveloped countries have established[37] and commercial banks which may be authorized to deal in foreign exchange under regulations supervised either by the central bank or a specially esta-

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37 For a brief early description of financial institutions in Asian countries see "Mobilization of Domestic Resources for Economic Development and the Financial Institutions in the ECAFE Region" in Vol. I., No. I of the Economic Bulletin for Asia and the Far East (First Quarter, 1950), pp. 20-28. Development of indigenous financial institutions, especially central banks, has tended to await political independence.

blished exchange control authority. Second, exchange controls are the most versatile of the commercial policy instruments in that they, more than tariffs or quotas, can be designed to yield effects in any direction that other commercial policy instruments can. Exchange controls, as noted previously,[38] may be designed to operate with an initial impact either upon quantities or upon prices and costs, thus making possible direction of economic activity by prohibition, by permission and/or by positive inducement. Third, in extension of the second point, exchange control is the only commercial policy instrument that makes possible direct control over money capital flows and other invisible transactions in the balance of payments. Fourth, exchange controls provide a technique for virtually complete mobilization of the means of consummating foreign trade transactions so as to channel such trade along lines most stimulating to economic development. Add to the foregoing points the flexibility of exchange control measures in adjustment to changing conditions and the increased use of exchange control measures, especially by underdeveloped countries, becomes understandable.

The considerable versatility of exchange controls, i.e., the fact that it is possible with some exchange control feature to pursue each of the commercial policy objectives, is alone nearly sufficient explanation for their having been tried in pursuit of each of the various objectives, at some time or other, by some country or other. Such versatility of exchange controls is not, however, justification for their being relied on for every development purpose.

Virtually complete reliance on exchange controls for pursuing

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38 See above, p. 52f.

development policy objectives would require constantly changing regulatory provisions and make the exchange control system so complex and unstable that the uncertainties and risks created would be disruptive of private initiative. In general, the less erratic the controls, the more conducive they will be to private activities that complement government policies aimed at steady development.

However, even limiting exchange control measures primarily to furthering a few main development objectives would involve more stringent control than mere supervision and/or more than one exchange rate. Consequently, the following analysis is carried on in terms of various exchange licensing provisions and multiple exchange rate situations.

Foreign Exchange Availabilities for Development

Exchange controls can be most useful in furthering those commercial policy objectives for development that involve either the availability or allocation of foreign exchange for development.

Mobilization of foreign exchange for development is a special province of exchange controls. Complete mobilization of foreign exchange under government control involves a requirement for all foreign exchange transactions to be conducted through financial institutions, public and/or private, that are authorized to deal in foreign exchange. Proceeds from investments abroad, e.g., from foreign securities and other invisible transactions, as well as from commodity exports, have to be surrendered at the official buying rate, or rates, fixed by the regulatory authorities. Foreign exchange for importation has to be obtained from the authorized agencies at the official selling rate or rates.

Any such arrangement is likely to be by-passed to some extent by the establishment of a black market, although black market operations can be kept at a reasonably low level with fairly simple licensing, declaratory, or registration devices.[39] Alternatively, it is possible to control black markets by legalizing them in a so-called "free" market[40] with transactions still to be made through authorized banks. Such "free" markets gain some control over the nature and extent of otherwise illicit foreign exchange transactions.

Quantity control can be exercized through licensing foreign exchange purchases for particular uses. Price and cost direction can be exercised through the establishment of differing official buying and selling rates on foreign exchange from the various sources and for the various uses.

Increasing Foreign Exchange Earnings. Exchange controls to increase the foreign exchange available for development uses can function most directly through measures to increase foreign exchange earnings, gross and net. Measures to increase foreign exchange earnings may include measures to control money capital flows, to encourage exports, and to encourage foreign investment.

Reduction of the total of money capital out-flows can increase net exchange earnings. Total exchange earnings may be increased by selective licensing of foreign exchange for money capital exports in the form of investment in foreign securities or earning assets that are especially

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39 See Mikesell, R., Foreign Exchange in the Postwar World, Twentieth Century Fund, New York, 1954, pp. 66-68.

40 For a description see above, p. 53.

productive of foreign exchange as dividends or interest. Requirement of registration of such investments and surrender of the resultant foreign exchange proceeds could convert an otherwise undesirable leakage of private savings abroad into a very important source of foreign exchange for development uses.

Permitting an orderly, controlled movement of the money capital of the wealthy could be as productive of foreign exchange for development and for combating balance of payments deficits as encouraging investment of such funds in new export or import-competing enterprises. One disadvantage of such a policy is that funds invested abroad in this manner do not generate income at home. Whether or not this would constitute a larger leakage from the domestic income stream than would otherwise occur would depend upon what disposition would otherwise be made of the funds. Should the funds alternatively be dissipated in increased liquidity, as tends to happen, a policy permitting the funds to flow abroad would not constitute a net reduction in the domestic income stream. If the proceeds of such financial investments abroad had to be surrendered at an unfavorable (low) official buying rate, they could turn up as an eventual expansion in domestic income as a result of government spending.

If invisible transactions of all kinds are not to escape the revenue levy applied through tariffs to transactions involving tangibles, differential official exchange rates--low buying rates relative to high selling rates[41]--must be applied to invisibles transactions. Such a revenue levy could take any of several forms of exchange taxes rather than

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41 See above, p. 55.

differential official exchange rates, with a possible advantage of separating the revenue objective from the other objectives in terms of instruments employed. In either case, the result would be, in effect, a multiple exchange rate system as defined by the International Monetary Fund.[42] Any such use of exchange controls for revenue should be made only with judicious coordination with other exchange control objectives as here discussed. Furthermore, revenue maximization requires that the disincentive effects on the transactions affected be held to a minimum.

Any outflow of capital funds uses foreign exchange and cannot be permitted to assume large proportions in the short-run because the capacity to import tangibles of an essential nature on current account would be unduly restricted. Capital flights into liquidity, speculation or even earning assets abroad which tend to be bunched during periods of balance of payments crises aggravate the payments problem and disrupt development programs. It is therefore necessary that capital flights bunched in the short-run be prevented. Accomplishment of this would be facilitated by permission of orderly movements over extended periods. This policy could only be exercized by implementation of exchange controls requiring that all foreign exchange transactions be conducted through authorized banks and subject to registration and licensing.

Another aspect of control over money capital export is significantly related to any policy designed to encourage money capital imports in the form of foreign investments. Mikesell emphasizes the deterrent effects that exchange controls may have on foreign investment. In his

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42 See footnote 21, p. 80.

discussion, restrictions placed on the transfer of earnings or repatriation of invested capital are given prominence.[43] This emphasis is based on the responses to a questionnaire by companies responsible for a large portion of American investments abroad which indicated that foreign trade and exchange controls were important obstacles to private foreign investment in underdeveloped countries.[44]

It is possible that such obstacles apply primarily to less desirable investments from the standpoint of development needs, for these needs do not necessarily coincide with the investment objectives of many foreign firms. Desirable foreign investments can be encouraged by liberal exchange policies toward the transfer of earnings and repatriation of capital, as well as by favorable treatment of the resultant enterprises with respect to necessary imports and to exchange rates for remittances and local purchases. The point is that "foreign capital is still warmly welcome..., although the new policy is to channel it into selected fields under prescribed conditions, for the purpose of advancing and safeguarding the economic interests of the country. ...government assistance to private investment in general is larger and growing."[45]

In view of the desirability of foreign investments for development when made along specified lines, there is nothing inherently contradictory between exchange controls for development and foreign investments in

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43 Op. cit., p. 451.

44 The survey was conducted by the National Industrial Conference Board and the results reported in Obstacles to Direct Foreign Investment, April, 1951. Ibid., pp. 449-456.

45 United Nations, Secretariat of the Economic Commission for Asia and the Far East, "Laws and Regulations Affecting Foreign Investment in Asia and the Far East", Economic Bulletin for Asia and the Far East, Vol. VIII,

desired enterprises. In the past, the deterrent effects of exchange regulations on private investment have frequently stemmed from uncertainty as to future treatment. An avowed, consistent policy of promoting development can do as much to eliminate uncertainties in the general situation in underdeveloped countries and stimulate desired investment as absence of specific government regulations. It is possible, for example, to reduce uncertainties for foreign investors in approved enterprises and thus encourage money capital imports by guaranteeing to sell foreign exchange for dividend and interest remittance at the same official exchange rate that is paid for the foreign exchange involved in the money capital import. This policy would eliminate the risks involved in possible exchange rate changes between the time of investment and the remittance of earnings.

The point was made earlier that increasing exports is the most direct approach to increasing foreign exchange earnings.[46] Thus far in this analysis, export subsidies have been deemed the most effective means of increasing exports and, thereby, of increasing export earnings of foreign exchange. Actually, for this purpose, exchange controls have several advantages over direct payments of export subsidies.

Export subsidization that can be provided by controls on foreign exchange transactions tends to be just as effective as specific payments of export subsidies and, although less direct, more flexibly administered. By requiring the surrender of all export proceeds to the exchange control authorities with a favorable, i.e, relatively higher, buying

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No. I, May, 1957, p. 7.

46 See above, p. 48.

rate paid for the proceeds from those exports to be especially encouraged, an automatic export subsidy is established. This method involves a less firm committment to export subsidization than legislatively established subsidies, and tends to make easier a reduction or elimination of the subsidy by simply changing rates of exchange as the export industries become more firmly established, more efficient, and less in need of assistance. In fact, once the enterprise is established, a gradual reduction in the buying rate of the foreign exchange proceeds could be used to induce greater efficiency.

Furthermore, while export subsidies in whatever form involve payment of domestic currency to exporters, subsidization through the setting of favorable exchange rates is handled as a routine part of the activities of the exchange control authorities. This tends to be a more efficient, i.e., less costly, operation than collecting tax revenues and disbursing them as subsidy payments.

An alternative approach to favorable exchange rates for subsidizing favored exports under a system of exchange controls is the granting of export retention quotas to the exporters of goods favored for export. An export retention quota involves permission for the favored exporter to retain a portion of the foreign exchange proceeds from his exports. The subsidy usually derives from permission to use the retained exchange to import goods otherwise subject to general import restriction and, therefore, capable of being sold domestically at a profit. Aside from more general objections to the use of export retention quotas,[47] their

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47 See Mikesell, op. cit., pp. 461-2.

use in conjunction with exchange controls for development tends to inject greater complexities into the system and to weaken efforts to mobilize foreign exchange for development, especially efforts at allocating foreign exchange according to established import priorities for development.

Protection To Increase Foreign Exchange Earnings. It may be noted that exchange controls that encourage new export enterprises or that increase money capital imports through encouraging foreign investment, constitute measures which provide protection for internal production. An additional protective use of exchange controls which could also contribute to an increase in foreign exchange availabilities for development involves the encouragement of domestic investment in import-competing enterprises. Protection of import-competing enterprises would involve the charging of a higher domestic currency rate for the foreign exchange to be used in importing commodities the internal production of which was to be encouraged. Specific exchange licenses for importation would have to be required in order to apply the higher exchange rate to particular commodities.

If exchange licenses under this system limited the amount of exchange made available for such imports, quantity controls would be combined with exchange controls for greater effectiveness.[48] This combination of controls adds a price-cost restriction to supplement a quantity restriction. The primary advantage of combining control devices in this way, as compared with operating them separately, is to achieve

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48 See above, p. 99.

desired results through one control agency in place of two.

Exchange licenses coupled with restrictive exchange rates for the importation of particular commodities could be issued without quantitative restrictions. In this case, the protective effect would be exercised through the price mechanism in much the same way as a protective tariff. The same uncertainties as to the degree of the protective effect would exist in the use of either of these commercial policy devices. However, exchange rates could be adjusted more readily than tariffs to fit the protective needs as actual effects became manifest. Nevertheless, quantitative restriction would be more precise, and mixing exchange rate restriction for protection with quantitative exchange licensing tends to create excessive complexity in the exchange control system to no great advantage.

Where analysis of exchange controls for increasing foreign exchange earnings touches on the importation of particular goods, that analysis merges with analysis of exchange controls for allocating foreign exchange for development.

Allocation of Foreign Exchange for Development

The point was made in the preceding chapter that the primary concern in commercial policy for development is not the restriction of foreign trade in the sense of reducing the total volume. Underdeveloped countries need expanding foreign trade as a means of obtaining essential imports. Rather, commercial policy restriction for development must take the form of controls on the type of trade, especially imports.

Since foreign exchange is the means of implementing importation of

goods and services, exchange controls provide a fundamental approach to controlling the type of trade with a view to furthering development. Due to a tendency toward a general shortage of foreign exchange, relative to needs, in underdeveloped countries that are embarked upon development programs, a system of allocating foreign exchange for development must be designed to conserve foreign exchange including, especially, so-called hard currencies. The system must also provide for control over the pattern of imports with special attention paid to encouragement of the importation of goods deemed essential to the development process.

Conserving Foreign Exchange. For most underdeveloped countries foreign exchange must constitute such a large portion of the necessary financing of any development program that foreign exchange budgeting is as essential as general governmental budgeting. Exchange controls are a virtual necessity for implementing a foreign exchange budget, and in any event are the most effective means, since they can utilize either quantity or price direction. Since many of the exchange systems in underdeveloped countries have tended to develop on an ad hoc basis, foreign exchange budgets could be one of the most beneficial immediate commercial policy innovations for furthering development.

With economic development as the primary policy objective, conservation of foreign exchange for meeting development needs would be the core consideration in the foreign exchange budget. To this end, foreign exchange may be withheld from imports deemed non-essential from the view point of development by a system of quantity exchange licensing provisions. Where less stringent restriction is needed, as of semi-essentials, foreign exchange could be made available only at unfavorable

exchange rates. As pointed out previously,[49] any such priorities of imports would need to reflect the conditions of the particular countries in which they were established and would therefore vary from country to country. To avoid undesirable complexity which might hamper private investment and production due to increased uncertainties, the system of priorities should be defined only in terms of a few broad categories.

Imports that would promote development directly are not the only goods that would need to be classed as essential in order to avoid an inadvertent, extreme imbalance in the foreign exchange budget, and thus in the balance of payments. For example, if capital goods such as machinery and equipment constitute a large element of the essential category, it will mean an increasing future need for importation of parts and equipment for maintenance of an expanding stock of capital. Such induced increases in import needs must be carefully projected into future budget requirements in order to avoid disruption of the development process or extreme imbalance in the foreign exchange budget and the balance of payments.

Another consideration having the same general effects on the foreign exchange budget involves imports to meet consumption needs. In most underdeveloped countries, sizable portions of the goods necessary for maintenance of even the low levels of living achieved must be imported. Foreign exchange for these imports must be budgeted if living levels are not to fall. Furthermore, if the development policies prove successful and incomes increase, the pressures on the foreign exchange

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49 See above, pp. 67f.

budget from consumer demand will become greater. On the other hand, both the increasing consumption and maintenance-of-capital budget pressures will be mitigated to the extent that success in development results in increased foreign exchange earnings through increased exports, or to the extent foreign exchange availabilities are increased through successful development of truly competitive import-competing enterprises.

The term "scarce currencies" has come to be used in reference to the currencies of countries that tend to have relatively large year-to-year surpluses in their balance of payments vis-a-vis the world. Since the possibilities of earning these currencies in trade with third countries tend to become more remote the longer the situation persists, underdeveloped countries may find it necessary to give special consideration in their foreign exchange budgeting to conserving scarce currencies. This is especially true if the scarce currency countries are important sources of both non-essential imports and of imports particularly vital to the development process.

Exchange licensing of the scarce currencies on a restricted quantity basis under a system of priorities is the most effective exchange control method of conserving the scarce currencies for importation of those goods vital to development. It may be necessary to establish a more detailed classification of priorities pertaining to imports from a scarce currency country than that governing the exchange budget in general.

Controlling the Pattern of Imports. The foregoing analysis implies that control over the pattern of imports is integral to the budgeting of foreign exchange to conserve foreign exchange for development. The

primary consideration in allocating foreign exchange within the budget is to assure that foreign exchange will be used primarily for importation of goods essential to the development process.

When the general foreign exchange budget objectives of conserving foreign exchange for essential development uses and controlling the pattern of imports to further the development process are stated in terms of the more specific objective of actual encouragement of the importation of goods essential to development, another dimension is added to the question of what specific exchange control measures are best suited to fulfillment of the objective. While quantitative exchange licensing tends to have more precise effects in prohibiting semi- and non-essential imports provides only passive encouragement to the importation of essentials. Although such passive encouragement may be sufficient stimulus to the importation of essential consumption goods since they are needed or desired for their power to satisfy wants directly, it may not be sufficient stimulus to insure importation of goods essential for development of productive enterprises.

Assurance of the foreign exchange means for importing productive machinery, equipment, parts, fuels, etc. may not be sufficient to induce investments in such imports or in the enterprises in which they would be utilized. More positive encouragement can be provided through multiple exchange rates. Because of the tendency toward a general shortage of foreign exchange relative to development needs, a free market rate for foreign exchange in terms of domestic currency would tend to be high and thus discourage imports. A multiple rate structure provides a means of permitting partial devaluation of the domestic

currency to discourage non-essentail imports and the setting of a rate that overvalues domestic currency to subsidize the importation of essentials. An intermediate rate may be applied to at least a third category of imports, i.e., semi-essentials.

Nevertheless, even subsidization of capital imports, although a positive inducement, is still only permissive. Yet more strenuous policies may be necessary to attract private investment in such imports. Finally, if all inducements to private enterprisers fail, it may be necessary for governments to take the initiative.

However, another advantage of controlling the pattern of imports by means of a multiple exchange rate structure is that the devalued import rates for those goods whose importation is to be restricted provide a means whereby government can capture the windfall profits that would otherwise accrue to importers of such goods through increased domestic prices. Consequently, even when greater precision in restrictive effects is deemed necessary, it would be well to supplement quantitative restrictions with devalued import rates of exchange.

Exchange Controls for Revenue

The observations in the preceding paragraph indicate that a system of multiple exchange rates can be so structured as to raise revenue. By permitting the bulk of imports to enter only at exchange rates that garner, for the exchange control authority, more domestic currency per unit of foreign exchange than is paid for the foreign exchange proceeds from the bulk of exports, it is possible to raise considerable revenue from exchange controls. Various underdeveloped countries have done

so.[50]

Yet an exchange control system that brings in large amounts of revenue conflicts with the use of exchange controls for increasing exchange availabilities and encouraging essential imports. If foreign exchange supplies are extremely short, the bulk of imports will tend to fall in the essential category and for their encouragement require exchange rates which involve revenue loss rather than revenue gain. By the same token, subsidy exchange rates to encourage exports and thereby increase foreign exchange earnings reduce government revenues rather than raising them. Furthermore, using exchange controls for all three objectives makes the system very complex.

Even so, it is possible to structure a multiple rate system to increase foreign exchange availabilities and allocate exchange for development in such a way as to balance exchange profits and exchange subsidies within the system so as not to involve a drain on general government revenues. As suggested earlier, this would leave the government revenue objective of commercial policy to be pursued through a mildly discriminatory system of import tariffs and export duties on those primary exports having relative price-inelasticities of supply and demand.

Other Commercial Policy Objectives

Furtherance of some of the other commercial policy objectives for

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50 Indonesia provides a notable example. See United Nation, "The Application of Multiple Exchange Rates in Selected Asian Countries", Economic Bulletin for Asia and the Far East, Vol. 5, No. 3, November, 1954, pp. 24-30.

development tends to be more compatible with a system of exchange controls for increasing foreign exchange availabilities and allocating exchange for development than does the revenue objective. Such a system is fundamental to protection of the balance of payments. It would be particularly effective in protecting the balance of payments if a foreign exchange budget were carefully worked out. In addition, quantity licensing of foreign exchange can provide assistance in meeting balance of payments emergencies.

Another possible by-product of a policy of allocating foreign exchange for development might be increased private saving on the part of the wealthy elite. Probably the most effective commercial policy instrument for preventing unnecessary spending abroad on luxuries would be the requirement that all such exchange dealings be made through authorized banks under exchange licenses. Whether this would actually increase the volume of private savings would depend on internal controls directed to the same end as suggested previously.[51]

If an exchange control policy designed to increase the volume and total value of exports were successful, import capacity would be increased. An increased import capacity, especially for consumption essentials, would do much to alleviate inflationary pressures resulting from otherwise restricted imports. Inflation and a balance of payments deficit are virtually inevitable during a period of rapid development. Factors making for complete price level stability tend to retard economic growth, but so does run-away inflation. While exchange controls could probably

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51 See above, p. 75.

contribute more to control of inflation than the other commercial policy instruments, internal monetary and fiscal policies would probably be required for placing a reasonable damper on inflation during the development process. The contribution of commercial policy to general success in economic development provides its greatest promise for controlling inflation in the long run.

Finally, it was pointed out in the analysis of export quotas that few underdeveloped countries are in an export position which will permit them to do much to influence their terms of trade in the short run. If they were, the control over quantity that can be exercized by exchange controls would mean that these could be used to improve the terms of trade. However, the support which it was suggested that exchange controls can lend to the diversification of exports does mean that exchange controls can contribute as much or more than the other commercial policy instruments to improvement in the terms of trade in the long run.

Summary

In summary, the foregoing analysis suggests that there are advantages of specialization to be exploited in the design of commercial policies for development. The advantages of establishing functional specialization in the use of the broad types of commercial policy instruments--tariffs and foreign trade subsidies, quantitative controls, and exchange controls--are to be found in a simpler structure of each instrument's system which will mean fewer internal contradictions in each system and more efficient promotion of the limited objectives of

each.

In terms of the major commercial policy objectives, it is suggested that tariffs should be reserved primarily for raising government revenue with assistance for other objectives built into the system only as they are consistent with the main revenue purpose; that quantitative controls should be reserved primarily for protection both of internal producers and of the balance of payments in emergencies; and that exchange controls should be used essentially for increasing foreign exchange availability and for allocation of foreign exchange for development. Of the three commercial policy instruments, exchange controls can contribute most to controlling inflation, although for controlling inflation, improving the terms of trade and adjusting the balance of payments in the long run, commercial policies can make their greatest contribution by general success in furthering development. As development occurs, these three problems will become less acute.

CHAPTER V

EMPIRICAL ANALYSIS OF COMMERCIAL POLICIES IN SELECTED CASES 1949-1959

The seeming shrinkage of the world set in at an accelerated rate during World War II due largely to such influences as improved, more rapid transportation and communication and the far ranging mobility of persons that was stimulated by the war. The shrinkage has seemed to continue at an increasing rate since the war due to such factors as jet propulsion, electronics development and apparently impending space travel. These changes have increased the frequency of what the anthropologist refers to as "culture contacts," and have contributed to an accelerated rate and expanding geographical spread in the occurrence of the "demonstration effect".[1]

For purposes of the present analysis, the important point for economic development is the timing of the expansion in economic aspirations. The widespread adoption of economic growth as the primary national objective has occurred essentially since World War II. Emphasis on economic development as national policy did occur on a scattered basis in the presently less developed countries as early as the 1920's, notably

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1 The concept of the demonstration effect was conceived by Duesenberry in reference to the relation of saving and consumption out of high and low family incomes. See J. S. Duesenberry, Income, Saving and the Theory of Consumer Behavior, Cambridge, Mass., 1949. The concept was enlarged by Nurkse to apply to the relation of saving and consumption out of high and low national incomes. Nurkse, op. cit., Chap. III. It is enlarged further here to refer to the general effects of Nurkse's concept, i.e., the broadening of the economic aspirations of the peoples of underdeveloped countries induced by increasing awareness of economic attainments in developed countries.

in some South American countries.[2] This fact at least partially explains why Uruguay, Argentina, Chile, Columbia, Brazil and Mexico had per capita incomes in 1953 ranging from 100 to 400 per cent greater than the per capita income of any Far East country, with the exception of Japan.[3]

Adoption of any policy as "national" policy must await the achievement of political independence. Most countries of Asia did not achieve political independence until after World War II, and political independence is only just coming to most African areas. Furthermore, the damping effects of the world wide depression of the thirties contributed to a belated pursuit of economic development, as opposed to economic recovery, as the primary national policy objective of most of the South American countries.

Under these circumstances, commercial policies of most underdeveloped countries have only begun to be oriented toward development objectives specifically since World War II. In addition, wartime dislocations and postwar adjustments tended to exert the dominant influence on commercial policy decisions for some years following the war. For the foregoing reasons, the analysis in this chapter deals primarily with commercial policies during the decade, 1949 to 1959.

The chapter has been planned to concentrate primarily on analysis of commercial policy actions that were emphasized in the theoretical analysis of the preceding chapter as holding greatest promise for furthering economic development. However, the effects of some alternatively

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2 See Wythe, Industry in Latin America, Columbia University Press, New York, 1945.

3 Kindleberger, Economic Development, Table 1.1, p. 6.

adopted commercial policy actions are analyzed, evaluated and compared. A brief background summary of economic conditions and developments over the subject decade precedes the analysis of commercial policies.

By countries, the analysis has been narrowed to cover Brazil, Chile, Colombia, Ecuador, India, Mexico, Pakistan, Peru, and the Philippines. These countries have been singled out for emphasis in the analysis for a variety of reasons. First, they represent a range of stages of development, as measured by per capita income, of from very low to relatively high.[4] Yet, second, they have all demonstrated through general policy actions an emphasis on economic development.[5] Third, these countries represent a geographical distribution, in Asia and Latin America, that represents diversity of natural resource patterns. Fourth, the relative population pressures on the natural resource capacities in these countries cover a wide range of man/land ratios. A fifth influence on this selection of countries hinged on the availability of information concerning commercial policy measures and statistical data that give indication of policy effects, although even for these countries some gaps become evident. Sixth, at least during most of the period under discussion, these countries have experienced relative political stability.

The final reason for selecting these countries for study is the primary one. These countries represent diversity in the use they have made of the different commercial policy instruments. Mexico and Peru

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4 Ibid.

5 Regarding Latin American countries see Wythe, op. cit.; regarding Asia see Table 8, Economic Bulletin for Asia and the Far East, IX (1950),

have depended rather heavily on manipulation of tariff rates to influence their foreign trade along development lines. Mexico, however, especially in more recent years, has increased its use of quantitative restrictions. In addition to Mexico, India, Pakistan and the Philippines have emphasized quantitative controls over foreign trade. Brazil and Chile, during various periods in the decade under discussion, have relied heavily upon exchange rate systems. Brazil has tended to avoid "playing favorites" as between tariffs, quantity controls and exchange controls. Most of these countries have established foreign trade subsidies in various forms, but this is true of Mexico especially.[6]

General statements regarding uses of commercial policy for development in underdeveloped countries and their effects are based on the experience of all nine countries. In order to restrict the length of this empirical analysis, however, the more detailed analysis of tariff and foreign trade subsidy manipulations concentrates on Mexico and Peru, the analysis of quantitative restrictions on Mexico, and of exchange controls on both Chile and Brazil. Brazil's experience with all of the commercial policy instruments is frequently analyzed for comparison and contrast.

No. 3, p. 14.

6 The summary information contained in this paragraph has been gleaned from a number of sources, but, especially, Isaacs, op. cit.; Wythe, op. cit.; the IMF Annual Reports on exchange restrictions; the United States Department of Commerce, World Trade Information Service (WTIS), Operations Reports and Economic Reports, and Foreign Commerce Weekly covering 1950 to 1960.

GENERAL INDICATIONS OF ECONOMIC DEVELOPMENT IN THE SELECTED COUNTRIES, 1949-1959

In the selected countries, the changes in national income (1950-1956 or 1957) have ranged from a low increase of 14% in Pakistan to a high increase of 50% in the Philippines. In terms of annual growth rate of national income for the years presented in Table 1, the

TABLE 1. CHANGES IN REAL NATIONAL INCOME AND REAL PER CAPITA PRODUCT (OR INCOME*) FOR SELECTED COUNTRIES BETWEEN YEARS INDICATED (Percentage)

Country	Percentage Change in National Income	Percentage Change in Per Capita Product (or Income*)
Philippines (1950-1957)	50	23*
Peru (1950-1956)	23	21
Mexico (1950-)	44 (1957)	18 (1956)
Brazil (1950-)	24 (1957)	16 (1956)
Ecuador (1950-1957)	47	15
Colombia (1950-)	38 (1957)	15 (1956)
India (1950-1956)	20	13
Pakistan (1950-1957)	14	2
Chile (1950-1957)	18	-3

Sources: Percentage change in national income was calculated from United Nation, Statistical Yearbook 1958, Table 160, pp. 429f and Table 159, pp. 419ff. Percentage change in per capita product was taken from ibid., Table 161, p. 431. The per capita income figure for the Philippines was calculated from the same sources as the national income data plus ibid., Table 1 (on population), p.31.

Philippines (7.14), Ecuador (6.7), Mexico (6.3), and Colombia (5.4) have made the most progress. The progress of Peru (3.83), Brazil (3.4), and India (3.33) has been moderate. Chile (2.57) and Pakistan (2.0) had the least satisfactory annual growth rates.

The performance of the economy in Chile has resulted in an actual decline in product per capita of three percent between 1950 and 1957.

Pakistan experienced only a two percent increase in product per capita over the same period. The increase in per capita product (1950-56) in India, Colombia, Ecuador, Brazil and Mexico covered a five percent spread from 13 percent in India to 18 percent in Mexico. The greatest economic development among the subject countries occurred in Peru, with an increase in per capita product of 21 percent (1950-56), and the Philippines, with an increase in income per capita of 23 per cent (1950-57).[7]

Over the decade 1949-1959, international trade of the selected countries has increased both by quantum and value of both imports and exports.[8] However, there have been fluctuations in these foreign trade categories under pressure of variable circumstances in the selected

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7 Where the terms of trade have turned in favor of the countries for which per capita product data is given as between the prior and later years, the effect would be to understate the improvement in their per capita incomes. For the appropriate periods, the terms of trade worsened considerably for Pakistan (73%), slightly for Peru (6%) and Mexico (6%), improved slightly for Ecuador (1%), Brazil (1%) and Colombia (5%), and improved moderately for Chile (11%). India's terms of trade were not available for 1950, but on a 1953 base stood at 104 in 1956. See United Nations, Economic Commission for Asia and the Far East (ECAFE), Economic Bulletin for Asia and the Far East, Vol. IX, No. 2 (September, 1958), p. 56, and United Nations, Economic Commission for Latin America (ECLA), Economic Bulletin for Latin America, Vol. III, No. 2 (October, 1958), p. 61. These publications will be referred to in all subsequent citations as ECAFE, Economic Bulletin, and ECLA, Economic Bulletin.

8 This is not true for Pakistan whose value of foreign trade declined from a high in 1951. For data on the foreign trade by value of the Latin American countries see ECLA, Economic Bulletin, September, 1958, Table 16, p. 57 and WTIS, Part 3, No. 60-4, Tables 2 and 3, pp. 3-7. For value of trade for Asian countries see ECAFE, Economic Survey, 1959, Table 15, p. 125 and ECAFE, Economic Survey, 1959, Table 15, p. 125 and ECAFE, Economic Bulletin, November, 1953, Table 4, p. 36. For quantum data on Latin America see Table 18, p. 58, of the previously cited issue of the Survey, 1959. Quantum data is not available on the foreign trade of Pakistan.

countries during the period.

In all of the nine selected countries, the volume of trade by value declined in 1949. This decline coincided with the waning of pent-up world demand for goods following the war. The value of exports of all of the subject countries, except Colombia and the Philippines, also declined in 1949. In the case of the Philippines, the rise in exports was a part of her postwar trend of recovery from wartime destruction of productive facilities.

Exports rose for eight of the nine countries in 1951[9] under the influence of increased demand stimulated by the Korean War, which started in the middle of the preceding year. The factors influencing foreign trade in the ensuing years varied from country to country, yet on balance exports and total trade by value decreased during the years 1952 and 1953 and rose from 1954 through 1956. Exports of the selected countries declined on balance in 1957, as did both exports and total trade in 1958. Both of these categories were on the rise in 1959. The trade positions of the nine countries were apparently little affected by the recession in the United States in 1953-54, yet responsive to the boom period of 1955-56 and significantly depressed by the recession of 1957-58. Economic gains in the United States and Western Europe were partially instrumental in the trade rise during 1959.

Imports by value in the nine selected countries have fluctuated widely during the decade, 1949-1959. The import fluctuations have tended to be associated with fluctuations in export earnings or balance of

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9 Ecuador was the exception, but her exports had doubled in 1950 over 1949.

payments positions, but on a lagged basis. When exports increased significantly in one year, the tendency was for imports to rise--and be permitted to rise--the following year. The same lagged response of imports was noticeable when exports increased in each of two or three years successively. In many of these instances the expansion of imports was exorbitant relative to the export levels in the years in which the

TABLE 2. INCOME PER CAPITA IN THE SELECTED COUNTRIES, 1949
(U. S. Dollars)

Country	Income Per Capita
Chile	188
Colombia	132
Mexico	121
Brazil	112
Peru	100
India	57
Pakistan	51
Philippines	44
Ecuador	40

Source: United Nations, National and Per Capita Income in Seventy Countries, New York, 1949, p. 14.

increase in imports occurred, necessitating policies of contraction of imports the next year.

Several factors have influenced the economic and foreign trade development so far described. Some of the significant factors are (1) previously attained economic levels, (2) the pattern of natural resources, and (3) the man/land ratios.

The nine selected countries are ranked in Table 2 according

to per capita income levels already achieved by 1949. In view of their low levels of attainment generally, the higher the income level the broader is the base for further progress. However, this generalization has not proved valid for Chile, whose performance in increasing the per capita income level has been the least successful in spite of starting the decade at the highest level. Chile's commercial policy has been protective of domestic producers, but restrictive rather than stimulative[10] and her monetary and fiscal policies have not been generally expansionary.

On the other hand, if a country starts at a low income level, a small absolute increase in income will represent a larger percentage increase than when it starts at a high level. Ecuador and the Philippines, which are at the bottom in Table 2, achieved the highest annual rates of increase in national income over the years 1950-1957.

The diversity among the subject countries in patterns of natural resources and the man/land ratios have influenced the relative levels of economic development which the countries have attained. These diversities have also affected the relative success of policies for development, including commercial policies.

The pattern of natural resouces in the various countries has partially determined the range of primary commodities readily available for export. If the range of exportable commodities is narrow, i.e., restricted to only one or two significant foreign exchange earners, the prospects for foreign trade to act as a reliable "leading" sector in the process

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10 The inadequacy of protective policy alone was noted above, p. 92.

of development are restricted.[11] Furthermore, sudden shifts in demand for a few primary-commodity exports tend to be disruptive of development programs, and make development uneven and planning difficult. On the other hand, the existence of diversity in the export base or of a potential for diversification will favor success in development policies.

Of the selected countries, those with a narrow export base are Brazil (coffee), Colombia (coffee and petroleum) and Pakistan (raw jute and raw cotton). Chile and Ecuador export only two or three commodities that are of significance by value, although the range of minor exports is wide enough to provide export diversification potential. The exports of India, Mexico, Peru and the Philippines are more varied than those of the other subject countries. About forty percent of India's exports are manufactured commodities. Pakistan appears to have the least potential for export diversification.[12]

The man/land ratio underlies the pressure of population on food-production potential. In underdeveloped countries, the adequacy of food production can affect significantly the international trade position of the country. In various of the selected countries, one or two basic grain-food imports can mean the difference between a surplus or a deficit in the balance of payments.[13] Expansion in the production of the crucial

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11 For a discussion of foreign trade as a "leading", "lagging", or "balancing" sector in the development process, see Kindleberger, Economic Development, pp. 245-255.

12 For the data on the Latin American countries see ECLA, Economic Bulletin, October, 1958, Tables 29 and 30, pp. 67-71. On the Asian countries see ECAFE, Economic Survey, 1958, Tables 6 and 8, pp. 188 and 193f.

13 For example, in Mexico, in 1958, crop failures of 1957 made necessary an increase in food imports greater than the balance of payments

commodities can ease the balance of payments problems of a country embarked on development. A poor food-crop year can disrupt the whole development process by forcing a shift in foreign exchange allocation from machinery and equipment imports to emergency imports of food.

The relative starting positions of the selected countries in the adequacy of food-crop production has a fundamental influence on their development potential and the relative difficulties they face in formulating commercial policies. The countries most favorably situated with

TABLE 3. RECENT POPULATION DENSITIES AND AVERAGE ANNUAL GROWTH RATES IN THE SELECTED COUNTRIES

Country	Persons per Square Kilometer	Average Annual Increase in Population (Percents)
India	121	1.25
Pakistan	91	1.9
Philippines	80	2.9
Mexico	16	2.83
Ecuador	15	2.7
Colombia	12	2.2
Chile	10	1.7
Peru	8	2.1
Brazil	7	2.4

Source: United Nations, Demographic Yearbook, 19[illegible].

respect to this consideration are those that are able to produce domestically nearly all of their food requirements.

Of the nine selected countries, India, Pakistan, the Philippines, Peru and Chile face the most difficult food production situations and import substantial amounts of basic food stuffs, especially rice or wheat.

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deficit. WTIS, Economic Reports, Part 1, No. 59-36, p. 1.

Colombia, Ecuador, Brazil and Mexico have achieved the most favorable positions regarding food production, and the latter three are exporters of basic food crops. Table 3, showing population densities and average annual growth rates, gives some indication of the reasons for these relative agricultural performances. The performances of Peru and Chile, however, need further explanation.

Additionally, Peru faces a food deficit because of limited arable land areas due to its expanse of Amazon river jungle. Chile, on the other hand, has a potentially high arable land to population ratio, and was virtually self-sufficient in food until 1940. However, due to policies restrictive of exports and domestic price controls on food items, Chile's agricultural development has not kept pace with her population increase.

TARIFF EXPERIENCE

Tariffs for Revenue-A General Summary of Practices

Before World War II, or during the earliest postwar years for which the information is available, all nine of the selected countries obtained more than one-fourth of their governmental revenues from customs duties levied on imports or exports or both. With only two exceptions (Colombia and India), the percentage of total revenues obtained from customs duties was larger the lower the per capita income (as estimated for 1953), and vice versa. By the latest year for which data is available (1957, 1958 or 1959), all but two of the countries (Peru and Ecuador) had reduced the ratio of customs duty collections to total

revenues.[14]

The reasons for the decline in the ratio varied from country to country. In no case was the decline in the ratio due to an absolute decrease in customs collections, even when two postwar years are compared; rather it was due to increases in other revenues. In the most recent years for which data is available, six of the nine subject countries collected one-fourth or more of their revenue from customs.

TABLE 4. RATIOS OF TARIFF (CUSTOMS) REVENUE TO TOTAL GOVERNMENT REVENUE FOR THE SELECTED COUNTRIES*
(Percentages)

Country	Prewar or Earliest Available Data	Latest Available Data
Chile ($250)	27 (1940)	20 (1958)
Colombia ($250)	40 (1939)	33 (1958)
Brazil ($215)	30 (1938)	16 (1958)
Mexico ($200)	33 (1939)	25 (1958)
Peru ($140)	33 (1953)	33 (1958)
Ecuador ($100)	35 (1951)	42 (1957)
Philippines ($90)	50 (1950)	26 (1959)
India ($60)	26 (1956)	18 (1959)
Pakistan ($60)	50 (1950)	26 (1959)

*The countries are ranked according to per capita incomes for 1953 taken from Kindleberger, Economic Development, Table 1.1, p.6.
Source: United Nations, Statistical Yearbook, 1958, N. Y., 1958, Table 171, pp. 462-512.

The policy of significant reliance on tariffs for revenue has not been a consistent policy of all of the selected countries during the decade under study. In the Philippines, for example, principle reliance for government revenues from the foreign trade sector was on a 17 percent

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14 See Table 4.

tax on sales of foreign exchange during the five years 1951-55. This exchange tax was instituted on March 28, 1951, and abolished on December 31, 1955. It was replaced by a special import tariff on January 1,1956, which was followed by a major tariff revision that became effective on July 1, 1957[15] and garnered 26% of the government's revenue during 1959.[16]

Brazil has consistently collected more revenue from government profit on its foreign exchange control system than from tariffs. Tariff revenues ranged from 2.5 to 5.9 percent of total revenues during the years 1953-57.[17] A major tariff revision was put into effect in August, 1957. Tariff revenues were increased by instituting ad valorem duties ranging up to 150 percent. The specific duties which had been in effect since 1934 had fallen to a low ad valorem equivalent due to increases in the general price level during the post-war years.[18] Yet, even in 1958, foreign exchange control profits appear to have exceeded tariff revenues which were 16 percent of total revenues.[19]

In the case of Chile, also, revenue has been obtained from profits on a multiple exchange rate system (up to 1956), as well as from taxes on large foreign-owned mining companies whose exports of copper and nitrates are the source of approximately three-fourths of Chile's foreign exchange earnings. In 1956, a complex multiple exchange rate system was

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15 WTIS, "Economic Developments in the Philippines-1957", Economic Reports, Part 1, No. 58-19, pp. 8-9.

16 See Table 4.

17 U. N., Statistical Yearbook, Table 171, p. 487.

18 WTIS, Economic Reports, Part 1, No. 58-87, p. 17.

19 Foreign exchange profits were not listed separately in the data, but were included in a category entitled "Other". This category was more than double import tariff revenues. See U. N. Statistical Yearbook, 1958, Table, 171, p. 487.

abolished with establishment of two free exchange markets, one for commodities and the other for invisibles. Revenue was still collected from a tax on sales of foreign exchange.[20] Nevertheless, revenues from tariffs constituted 20 per cent of total revenue in 1958.

The tariff revenue of all the selected countries, except Mexico, has been derived primarily from duties on imports. In Mexico, export duties have consistently brought in slightly more tariff revenue than import duties during the postwar years. Revenue from Peruvian export duties, especially on agricultural and mineral exports, has averaged one-third or more of customs revenues. Indian export duties have accounted for one-sixth to one-fourth of customs revenues. As high as one-sixth of customs revenue has come from export duties in Ecuador.

Tariffs with Other Objectives

Effects on Inflation. Each of the nine selected countries levies specific import duties on a wide range of commodities. Revisions in specific duties have not been as frequent as revisions in ad valorem duty rates. Furthermore, the unit value of imports for the selected countries has tended upward over the decade, although it has fluctuated from year to year.[21] Due to the nature of specific duties, the revision inertia, and the upward import price trend, the burden of the specific duties has tended to decline.

Since the tariff revisions by Brazil and the Philippines in 1957, the tariff systems in all nine countries have utilized ad valorem duties

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20 IMF, Eighth Annual Report on Exchange Restrictions, 1957, pp. 71-77.
21 ECLA, Economic Bulletin, October, 1958, Table 20, p. 60, and ECAFE

predominantly. The advantage of this arrangement is its compensatory effects upon price levels. Ad valorem duties keep tariff collections more closely in line with price level changes. They thus combat further inflation by taxing away extra profits during price level increases, and relieve the heavier burden represented by specific duties during periods of price level declines.[22]

Controlling the Pattern of Imports and Protecting Domestic Producers. All of the selected countries have established graduated ad valorem rate structures in their import tariff systems which reflect judgments of priority of imports based on (1) essentiality to the domestic economy and (2) the ability of domestic producers to meet demand. Thus they have combined the revenue objectives as described above with control of the pattern of imports and protection of domestic producers.

The priority categories for imports are spelled out more explicitly in connection with quantity or exchange control systems. For example, in the exchange control system of Brazil, 1955, five categories of imports were established with increasingly less favorable, i.e., higher exchange rates applicable from Category I through Category V. The listing, which utilized tariff classification numbers, included the following partial list of items by category:

Category I (Lowest exchange rates applicable to essential commodities and commodities to promote employment and agricultural production.)

Economic Survey, Table 226, p. 137.

22 ECAFE, "Taxation and Development of Agriculture in Under-developed Countries, with Special Reference to Asia and the Far East", Economic

--Coal, tinplate, specified mineral ores, pharmaceutical raw materials, medical equipment, special electrical equipment, agricultural machinery, mining equipment, and scientific equipment.

Category II (Essential raw materials and other essential commodities.) --Specified metals, metal mill manufactures, industrial chemicals, industrial machinery for industries "most essential" to the economy, railway equipment and parts, and codfish.

Category III (Other raw materials and "highly essential" spare parts and equipment.) Cement, truck and bus chassis, specified metals and metal manufactures, railway equipment, chemical and other industrial raw materials, construction machinery, electrical equipment, and industrial equipment for "second-degree essential" industries.

Category IV--Specified fruits and other foodstuffs, machinery for processing foodstuffs, machinery for manufacturing clothing and other consumer goods, ferro-alloys and metal mill manufactures, and office equipment.

Category V (Highest exchange rates applicable.)[23]--All other commodities.[24]

Wheat, petroleum products, and equipment for production of items in categories I, II and III are subjected by Brazil to special treatment in most cases more favorable than that accorded any of the items

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Bulletin, Vol. IX, No. 1 (June, 1958), pp. 8-9.

23 For general descriptions of the categories see IMF, Sixth Annual Report on Exchange Restrictions, 1955, p. 62.

24 For detailed listings given see WTIS, "Licensing and Exchange Controls...Brazil", Operations Reports, Part 2, No. 56-1, p. 3.

listed in the five categories.[25] The priorities represented by the foregoing exchange control classifications were reflected in the major tariff revision put into effect in 1957.

> Work was completed during the year (1955) on a new customs tariff with the establishment of ad valorem rates for each of the approximately 8,000 commodities listed in the proposed new schedules....The proposed schedules include rates of up to 10 percent ad valorem for essential items; 11 to 60 percent for items for which partial protection is required; and from 60 to 150 percent for items requiring high protection or not considered essential for the economy.[26]

The Brazilian priorities are typical for all of the selected countries, although there are variations from country to country as to the specific commodities included in each broad category. These variations reflect the unique conditions of the countries involved; for example, India and the Philippines give priority to rice as a staple food import, while Peru and Brazil give priority to wheat.

In general, the commercial policy controls on imports are designed to restrict imports of consumer goods and encourage imports of capital goods, raw materials, and fuels. Consumer goods are restricted either because they are deemed non-essential luxuries or in order to protect domestic producers.

Thus, it is to be expected that imports of consumer goods would decline as a percent of total imports. This, in fact, has happened,

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25 Ibid, pp. 3-4.

26 WTIS, "Economic Developments in Brazil, 1955", Economic Reports, Part 1, No. 56-38, p. 7.

over the period 1949-56, for every one of the selected Latin American countries, except Peru.[27] This has also been the experience of India and the Philippines, although not of Pakistan, between 1953 and 1956. The counter-tendency in Pakistan is to be explained primarily by disasterous floods in 1955 which created a food crisis in 1956.[28] In the case of Peru, the time period is long enough to indicate differences in the relative effectiveness of commercial policy instruments.

Peru is the only one of the nine countries that utilizes neither quotas nor exchange controls extensively. The ratio of consumer-goods imports to total imports has increased in spite of the fact that Peru's tariff rates discriminate against luxury imports and imports that compete with domestic production.[29] Furthermore, the discriminatory tariff-rate structure is buttressed by a requirement of advance deposits in foreign currency of 100 percent of the import value, with banks permitted to finance the local currency equivalent up to 100% for wheat, meat and milk, up to 50 percent for raw materials, and prohibited from extending credit for nonessential imports.[30] There is a reasonable presumption, therefore, that tariffs are not as effective for restricting luxury imports and protecting domestic producers as are quotas and exchange controls.

Mexico has combined in her tariff policy control over the pattern of

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27 See Table 5, p. 138.
28 WTIS, "Economic Developments in Pakistan, 1956", Economic Reports, Part 1, No. 57-46, p. 1.
29 WTIS, "Economic Developments in Peru, 1956," Economic Reports, Part 1, No. 57-54, p. 9.
30 IMF, Fifth Annual Report on Exchange Restrictions, 1954, p. 275.

TABLE 5. CHANGES IN RATIOS OF COMMODITY GROUPS OF IMPORTS TO TOTAL IMPORTS FOR SELECTED COUNTRIES OVER SPECIFIED PERIODS, RANKED ACCORDING TO IMPLICATIONS FOR SUCCESS IN DEVELOPMENT* (Percentages)

Changes in Ratios of Consumer Goods Imports to Total Imports:

Country	1949-56	Country	1953-56
Brazil	- 6.2	India	-19.2
Colombia	- 5.2	Philippines	- 9.6
Ecuador	- 1.4	Colombia	- 6.6
Mexico	- 1.1	Mexico	- 3.2
Chile	- 0.1	Ecuador	- 1.9
Peru	+ 3.8	Brazil	+ 0.2
		Pakistan	+ 2.1
		Peru	+ 2.7
		Chile	+ 3.4

Changes in Ratios of Capital Goods Imports to Total Imports:*

Country	1949-56	Country	1953-56
Brazil	-13.8	India	+19.4
Chile	- 1.8	Philippines	+ 9.1
Mexico	- 1.2	Pakistan	+ 5.9
Ecuador	- 0.5	Mexico	+ 2.1
Peru	+ 0.2	Chile	+ 1.0
Colombia	+ 1.0	Ecuador	+ 1.0
		Colombia	- 2.5
		Peru	- 4.4
		Brazil	-10.6

Changes in Ratios of Raw Materials Imports to Total Imports:

Country	1949-56	Country	1953-56
Brazil	+ 7.7	Colombia	+10.0
Colombia	+ 4.3	Brazil	+ 3.6
Chile	+ 1.8	Ecuador	+ 1.5
Ecuador	+ 1.8	Peru	+ 0.8
Mexico	- 0.3	Philippines	+ 0.5
Peru	- 4.7	India	- 0.2
		Mexico	- 0.6
		Chile	- 1.6
		Pakistan	- 8.1

Sources: U. N., Economic Commission for Latin America, Economic Bulletin for Latin America, Vol. III, No. 2(October, 1958), Tables 22, 23, 24, 25 and 27, pp. 61-66; U. N., Economic Commission for Asia and the Far East, Economic Bulletin for Asia and the Far East, Vol. IX, No. 2(September, 1958), Table B, pp. 32-33.

*The ranking for capital imports is more ambiguous than for the other two categories. The percentage level of capital imports tends to be lower the higher the stock of capital with which a country starts a particular period. However, while an increase in the capital imports percentage may reflect faster development, a decrease in the capital import percentage may reflect greater production of capital domestically. For this reason, the order is reversed for the two time periods because of the inclusion in 1953-56 of the generally less developed Asiatic countries.

imports, protection for domestic industries, and reduction of balance of payments deficits. Therefore, Mexico's tariff policies are discussed in relation to the balance of payments in the following section.

Protecting the Balance of Payments with Tariffs. Little use has been made of tariff rate manipulations to combat balance of payments deficits. In periods of payments crises, those countries that have systems of quantity and exchange controls have tightened restrictions on imports in order to reduce demands for foreign exchange.[31] Since international payments deficits for underdeveloped countries usually occur during periods of inflation, due either to inadequate production levels, a period of relaxed monetary policy, or expansion of government spending, most of the nine countries have also responded to payments crises with internal anti-inflationary monetary and fiscal measures.

Peru has emphasized the domestic policy approach in conjunction with international and foreign agency assistance for reducing deficits in its balance of payments. A post-Korean decline in prices of metal exports, after high metal prices during the Korean War period had induced expansion of government and private buying abroad, precipitated an international payments crisis for Peru at the beginning of 1954.[32]

As an emergency measure to curb speculation Peru negotiated a stabilization credit of $30 million from the International Monetary Fund, the U. S. Treasury, and a private U. S. bank in February.[33] Follow-up

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31 See below, pp. 145f. and 160f.
32 WTIS, "Economic Developments in Peru", Economic Reports, Part 1, No. 55-70, p.1.
33 Ibid., p. 9.

measures by the government included reduced public works spending, stepped up revenue collections, and a shift to short-term borrowing at higher interest rates to finance the large 1953 government deficit.[34] Only a few tariff increases were insituted on consumer goods imports in support of the other measures.[35]

Mexico has utilized import tariff rate increases to reduce balance of payments deficits more extensively than any of the other selected countries. However, when balance of payments crises have become severe, Mexico has resorted to peso devaluation supplemented by higher import tariffs and stricter quantity controls on imports. The combined use of devaluation, tariff increases, and quantitative import restrictions makes separate analysis of the balance of payments effects of these three policy instruments difficult.

One indication of the inadequacy of tariffs alone for reducing balance of payments deficits may be found in their use prior to peso devaluation in August of 1948. In 1947, Mexico was experiencing inflationary pressures and a mounting balance of payments deficit. In that year, ad valorem rates were innovated in its import tariff schedule.[36] The new ad valorem rates were not high overall, but were levied on officially fixed, arbitrary values per unit of commodities. Greater restrictiveness was achieved, when desired, by raising official valuations of import commodities.

This measure proved inadequate to meet the balance of payments

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34 Ibid.
35 Ibid., p. 14.
36 U. S. Department of Commerce, Foreign Commerce Weekly, January 23, 1950, p. 20.

difficulties, and speculative capital flights from the peso in 1948 precipitated the devaluation action. The devaluation was supplemented in 1949 by increasing both the list of commodities (150 items) for which import permits were required and the list of commodities (330 items) importation of which was prohibited.[37] These combined actions had beneficial effects on the balance of payments, but these beneficial effects were relatively short lived.

After achieving balance of payments surpluses in 1949 and 1950, Mexico again experienced balance of payments deficits in each year from 1951 through 1954.[38] A similar pattern of events was repeated starting in 1954. In response to inflationary pressures and speculative capital flights, the peso was devalued on April 19, 1954. This action was supplemented by increased import duties and new import quantity restrictions.[39] Balance of payments surpluses were achieved in 1955 and 1956, followed by deficits in 1957 and 1958.[40]

Experience with Export Tariffs.

Of the nine subject countries, Mexico had made the greatest use of export duties. This fact was suggested in connection with the discussion of tariffs for revenue.[41] More specifically, Mexico instituted a

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37 Ibid.
38 These events are reflected in the fluctuations in gold and foreign exchange reserves. See U. N., Statistical Yearbook, 1958, Table 166, pp. 451ff.
39 WTIS, "Economic Developments in Mexico, 1954", Economic Reports, Part 1, No. 55-60, pp. 1-2.
40 U. N., Statistical Yearbook, 1958, Table 166, pp. 451ff.
41 See above, p. 133.

15 percent ad valorem export surcharge in August of 1948 to capture domestic-currency profits realized by exporters as a result of devaluation. This duty garnered substantial revenues.[42]

In addition, Mexico has instituted export tariffs and quantitative export controls to encourage development of the domestic economy. These measures have been applied to the agricultural and livestock industries to insure that domestic consumption needs are fulfilled first.[43] They have been applied to natural resources used by already established domestic industries to discourage exportation.[44] Differential export duties and selective quantitative export restrictions have been applied to domestically produced raw materials and their processed counterparts in order to encourage new domestic processing activities.[45]

With export tariffs and quantity controls used in pursuit of the same objectives, it is difficult to separate the effects of the two instruments on the pattern of exports and the diversification of domestic production activities. Therefore, the results of these policies are analyzed later in relation to quantitative controls.

FOREIGN TRADE SUBSIDY EXPERIENCE

Direct import and export subsidies have been so seldom used by the

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42 Foreign Commerce Weekly, January 23, 1950, p. 20.
43 WTIS, "Basic Data on the Economy of Mexico", Economic Reports, Part 1, No. 59-5, p. 7.
44 Ibid.
45 Ibid., p. 21.

selected countries during the decade under study as to provide no basis for evaluating these instruments. The nearest approach to direct import subsidies of significance has been government purchases of wheat in Brazil and government import monopolies of wheat, rice, sugar, coal and chemical fertilizers in Pakistan. The purpose of the import monopolies in Pakistan is to control the distribution and prices of necessities that are in extremely short supply.[46] The wheat imports by the Brazilian government are effected at exchange rates lower than for all other imports to supplement domestic supplies of wheat.[47]

Both import and export subsidization has been most extensively instituted in the operation of multiple exchange rate systems of exchange control. The effects of such measures are analyzed later in connection with exchange control experience.[48]

QUANTITATIVE CONTROL EXPERIENCE

Quotas and Revenues-the Problem of Windfall Profits.

When quantitative import restrictions are imposed, the domestic prices on the restricted commodities tend to rise, providing a windfall profit for the importer of the quantities of such commodities that are permitted entry. In the theoretical analysis, it was suggested that such windfall profits might be captured by imposing import license fees graduated according to the severity of the import restriction or by

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46 WTIS, "Licensing and Exchange Controls...Pakistan", Operations Reports, Part 2, No. 58-44, p. 1.

47 WTIS, "Licensing and Exchange Controls...Brazil", Operations Reports, Part 2, No. 56-1, p.4.

48 See below, p. 166.

instituting a system of competitive auction bidding for licenses.[49] A modification of the latter proposal has been utilized by Brazil since October, 1953, in the form of an importers' foreign exchange auction market.[50] However, the Brazilian system involves one of several possible combinations of quantity and exchange controls in which the exchange control features predominate. Those systems are evaluated in the section on exchange control experience.[51]

In fact, none of the selected countries has adopted the techniques suggested in the theoretical analysis of the preceding chapter as a means of capturing windfall profits on commodities whose importation they restrict. All have levied some form of tax for this purpose.[52]

In some cases, this tax has taken the form of a customs surtax levied in addition to the specific and ad valorem tariff rates included in the regular tariff schedule. In other cases, the tax has taken the form of sales or similar internal taxes levied upon the restricted import commodities. In all cases, these taxes have been graduated to bear more heavily upon those commodities whose importation has been most severely restricted.

For example, even Peru has levied an internal consumption tax against the one commodity (automobiles) on which it has placed quantitative import restrictions. The tax is seven percent of the value of all automobiles up to $1,500, and is graduated by $100 increases in value up

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49 See above, pp. 89f.
50 IMF, Fifth Annual Report on Exchange Restrictions, 1954, pp. 56-60.
51 See below, pp. 157ff.
52 See WTIS, Operations Reports (on import tariff systems), Part 2, various numbers.

to 45 percent of the value of automobiles valued between $2,901-$3,000. Two percent is added for every $100 increase in value above $3,000.[53]

In the Philippines:

> Most imported products--as well as most goods locally produced--are subject to excise taxes called percentage sales taxes. Rates are 100, 75, 50, 30, or 7 percent, depending on the classification of the commodities. The highest rates apply to luxuries and semi-luxuries. The tax is payable by the importer to the collector of customs ...calculated on landed costs---first inflated by 100 percent in the case of luxuries; by 50 percent for semi-luxuries; and by 25 percent for other products.[54]

Quantitative Import Restrictions

Peru is the only one of the nine selected countries that utilizes virtually no quantitative import restrictions on imports together with some form of exchange controls. However, Chile (until April 20, 1956), Colombia, Ecuador and Brazil have employed multiple exchange rates as the predominant controlling element in their system of control and will, therefore, be analyzed in connection with exchange controls.

The Philippines, India and Pakistan utilize quantitative controls predominantly. The Philippines achieves this through quantitative exchange licensing for essential imports and import licensing on an individual quota basis for other than essential goods. India and Pakistan control imports by licensing imports and making foreign exchange available automatically for authorized imports. Mexico is the only one of the

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53 WTIS, "Import Tariff System of Peru", Operations Reports, Part 2, No. 58-11, p. 2.

54 WTIS, "Import Tariff System of the Philippines," Operations Reports, Part 2, No. 57-103, p. 2.

selected countries that imposes quantitative restrictions without any exchange controls.[55]

Protecting the Balance of Payments. The purpose of instituting quantitative import controls (and exchange controls) usually has been to conserve foreign exchange and gold reserves at a time when the country was experiencing a deficit in the balance of payments.[56] The process of conserving payments reserves and of balancing payments is the restricting of the total value of imports to the level of foreign exchange receipts. It is possible, by quantitative import restrictions, to erase balance of payments deficits if this objective is pursued with a single-mindedness of purpose.

However, in the import control systems that have been established in the selected countries, protection of the balance of payments with conservation of payments reserves has not been an end in itself. Rather, it has been a means to the end of insuring that scarce foreign exchange will be used to meet the current economic needs and the economic development needs of the nation.[57] Thus, it is impossible to judge the effectiveness of quantitative import restrictions in protecting the balance of payments by what has happened to the balance of payments.

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55 For this summary see the entries for the various countries in IMF, First Annual Report on Exchange Restriction, 1950, except Pakistan, Second Report, 1951, Brazil, Fifth Report, 1954, and Mexico, Tenth Report, 1959.

56 This fact is reflected in the dates of origin of such systems: Chile, Colombia and Brazil (1931), Ecuador (1932), India and Pakistan (1939), Peru (1945), Mexico (1946) and the Philippines (1949). Ibid.

57 WTIS, "Licensing and Exchange Controls...", Operations Reports, Part 2, No. 57-45 (India), p. 1, No. 58-50 (Mexico), p. 1, No. 58-44 (Pakistan), p. 1, and No. 58-10 (Philippines), p. 1.

Furthermore, the quantitative import restrictions of the selected countries have not only reflected policy decisions as to essentially of imports, but have also provided protection for internal producers.

Protection of Internal Producers-Mexico. In the latter 1940's, Mexico established quantity controls on imports by declaring two lists of imports; one was commodities subject to licensing by the Ministry of Economy, the other, commodities prohibited importation. This system was originally established to conserve exchange reserves. While the balance of payments considerations are hardly ever completely submerged, the control decisions have increasingly reflected desire to protect domestic producers in addition to channeling available exchange resources into the acquisition of capital goods, necessary raw materials and other essentials.[58]

The items which have been placed on the control lists have included nonessentials or luxuries and commodities which would compete with "domestically produced equivalents or substitutes".[59] Representative of the restricted commodites are consumer goods such as (1) foodstuffs, cigarettes and alcoholic beverages, animal fats and vegetable oils, (2) household chemicals, disinfectants, soaps and detergents, (3) yarns and fabrics, wearing apparel and haberdashery, (4) leather products, footwear, luggage and wallets, (5) household furniture and appliances, washing machines, refrigerators, stoves, mixers, radios and television sets, and producer goodssuch as (1) metal products, iron and steel

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58 Ibid.
59 Ibid.

ingots, bars and wire, tinplate, copper wire and pipe, (2) industrial chemicals and chemical fertilizers, (3) cement, (4) paper and paperboard, glass tubes and containers, (5) machinery, electric motors, transformers and switchgear, (6) automobiles, trucks, buses and chassis.[60]

The results of this protective policy of import restrictions, accompanied by protective import tariffs,[61] tax concessions and financial aid through official credit institutions,[62] are indicated by the increased production of manufacturing industries. Between 1950 and 1957, production of producer goods, in physical units, was increased in various categories as follows: Metal products, about three times; chemicals, about four times; paper and paperboard, about three times; cement, rubber tires and tubes, glass products, automobiles and trucks, and railway cars, about double; and electrical equipment, about twenty times. Over the same period, production of consumer goods was increased as follows: Processed foodstuffs, canned foods, and beer, about fifty percent; clothing, textiles, cigarettes, matches, soaps and detergents, between forty and fifty percent; and wooden furniture, radio and television sets, and electric household appliances, about sixteen times.[63]

These gains in industrial production have accompanied higher levels of both private domestic and direct foreign investment. A study by

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60 Ibid., p.2.
61 WTIS,"Economic Developments in Mexico, 1954", Economic Reports, Part 1, No. 55-60, p.2.
62 WTIS, "Basic Data on the Economy of Mexico", Economic Reports, Part 1, No. 59-5, p. 14.
63 Ibid., Table 9, p. 13.

Nacional Financiere, an official credit institution, in 1957, indicated by industrial census data that private investments in 1955 and in 1956 were higher by about 100 percent than in 1950.[64] The level of direct foreign investments in manufacturing in 1957 was slightly over twenty times greater than in 1950.[65] The inducements to private domestic investment included general economic prosperity, credit availability through official institutions, and the protective commercial policies. The general economic prosperity and protection of internal producers were of greater relative significance as inducements to direct foreign investment.

Protection of Internal Producers-India, the Philippines, and Pakistan. As in the case of Mexico, the quantitative import restriction policies of India, the Philippines and Pakistan have included the objectives of protecting internal producers and controlling the pattern of imports for development.[66] As indicated by increases in production of manufactured products, these import control policies, along with other promotional and government investment activities, have been about as successful for these three Asiatic countries as similar policies have for Mexico.

In Mexico, between 1950 and 1957, manufacturing increased in value of putput by approximately fifty-five percent.[67] The index of manufactur-

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64 WTIS, "Economic Developments in Mexico, 1957," Economic Reports, Part 1, No. 58-36, p. 4.

65 WTIS, "Basic Data on the Economy of Mexico", Economic Reports, Part 1, No. 59-5, Table 10, p. 14.

66 See above, footnote, 57, p. 5-28.

67 U. N., ECLA, Economic Bulletin, III, 2(October, 1958), Table 8, p. 47.

ing output increased over the short period of 1953 to 1958 by thrity-one percent in India, by 122 percent in Pakistan, and by seventy percent in the Philippines.[68] While these comparisons may be indicative, direct comparison is impossible.

A particularly significant qualification is the fact that Pakistan and the Philippines started the period at much lower levels of manufacturing capacity. Pakistan was virtually devoid in industry following partition from India in 1947,[69] and the Philippines started with little else than light manufacturing.[70] In addition, the governments in all three Asiatic countries have assumed greater responsibility for investment than has the government of Mexico.[71] Thus, the changes in manufacturing as between Mexico and the three Asiatic countries are not comparable as indicators of the inducements to investment effected by the protective quantitative import restrictions.

Controlling the Pattern of Imports. Interpretation of the changes in ratios of commodity groups of imports to total imports can give some indication of the relative effectiveness of the main commercial policy instruments in controlling the pattern of imports. In Table 5,[72] it may be observed that India and the Philippines, of the countries using predominantly quantitative controls on imports, have been most successful

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68 U. N., ECAFE, Economic Survey, 1959, Table 11, p. 119.

69 WTIS, "Basic Data on the Economy of Pakistan", Economic Reports, Part 1, No. 55-102, p. 1.

70 WTIS, "Basic Data on the Economy of the Philippines", Economic Reports, Part 1, No. 58-57, p. 9.

71 This may be partially explained by the lower development starting points of the Asiatic countries. See above, pp. 23ff.

72 See above, p. 137.

in reducing the proportion that consumer goods imports are of total imports as between 1953 and 1956. Mexico is outranked in this respect only by Colombia. Pakistan ranks well toward the bottom, and Mexico is outranked over the period from 1949-56 by Brazil, Colombia and Ecuador.

In spite of the poor showing of Mexico from 1949-56 and of Pakistan, however, there is a reasonable presumption that quantitative controls on imports are most effective. Two factors tend to explain the poorer performance of Mexico during 1949-56. First, is the relatively greater increase in income in Mexico from 1950-57,[73] which would tend to cause a greater increase in the demand for consumption goods. Second is the fact that Mexico has increased its reliance on quantitative import controls in the latter (i.e., 1953-56) period. Pakistan's apparently relatively poor performance can be explained primarily by her difficulties in producing an adequate food supply domestically and her resultant need for large imports of foodstuffs.[74]

The judgment of greater effectiveness of quantity controls on imports tends to be supported by the data on changes in the ratios of capital goods imports to total imports, all four quantity control countries ranking at the top from 1953 to 1956. With regard to raw materials imports, India and Mexico have been relatively successful in producing these domestically and in reserving them for use in domestic industries through the application of export restrictions,[75] while the Philippines has too little industrial capacity as yet to utilize large amounts of

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73 See above, Table 1, p. 124.
74 See above, p. 129.
75 See above, fn. 57, p. 146.

raw materials, and Pakistan has been plagued by the necessity of importing for current consumption.

Flexibility of Quantitative Import Controls.

India, Pakistan, and the Philippines have quantitative import control systems with basically the same devices to achieve flexibility and continuing review of import control policy. All three permit nearly all imports only on the basis of individual licenses with specification of amounts or quotas. In the Philippines, the individual licenses are for specified quantities of foreign exchange for specified purposes. In India and Pakistan the licenses are for particular commodities in specified quantities with foreign exchange made available automatically.[76]

All three countries issue detailed import policy statements semi-annually. The import policies are based on a consideration of the country's needs and the overall availability of foreign exchange.[77] In addition, minor changes are sometimes made between regular import policy statements, and the Philippines occasionally revises its policy on a quarterly basis. These systems make possible continuing review and revision of import policies.

Even so, Mexico's system of quantitative import controls makes possible even greater flexibility than do the systems just described. Since the early 1950's, Mexico has utilized few specific import quotas or prohibitions, essentially only those common to most countries for public security, health and morals purposes. Import restrictions are

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76 Ibid.
77 Ibid.

exercised through ad hoc issuance of prior import permits for those commodities included in the list of controlled imports.[78] In 1958, this list included about one-third of the items in the Mexican import tariff, and comprised about fifty percent by value of Mexico's imports. This system permits Mexican officials to tighten or ease import restrictions as they see fit.[79]

In addition, additions to or removals from the import control list may be made by administrative decision upon publication in an Official Diary, without advance notice. However, to avoid the adverse effects on trading activities which fear of such sudden changes might have, officials issue import permits for recently added commodities upon proof that a firm order had been placed prior to the effective date of the addition.[80]

With regard to removal of import restrictions, it was suggested in the theoretical analysis that quantitative controls are a better short-run expedient for providing protection to domestic producers, than are tariffs, because quantitative controls may be more readily removed. Partially refuting this suggestion is the fact that many of the Latin American countries have given their chief executive the power to change tariff duties by executive order.[81] Nevertheless, changes in quantitative restrictions, during the decade under study, have been

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78 Similar freedom of action has been retained by Mexico in its tariff policy. It has refused to join the GATT, and prefers most-favored-nation treaties to specific tariff concessions. See WTIS, "Basic Data on the Economy of Mexico", Economic Reports, Part 1, No. 59-5, p. 20.

79 WTIS, "Licensing and Exchange Controls...Mexico", Operations Reports, Part 2, No. 58-50, p. 2.

80 Ibid.

81 A. Isaacs, op. cit., p. 460.

much more frequent and widespread than changes in tariffs.[82]

Easing and tightening of import restrictions in all four of the quantitative control countries have tended to be associated with fluctuations in their balance of payments positions. However, the only significant indications of removals of restrictions due to success in development of enterprises that are competitive in world markets are to be found in the increasing frequency of removals by Mexico from its list of controlled imports.[83]

Import Discrimination by Country of Origin. In the past, India and and Pakistan have made a distinction in their import control systems between imports from dollar (hard currency) areas, sterling block countries, and others.[84] With the easing of the dollar shortage in recent years, and the current dollar surplus, such distinctions as to origin of imports have almost disappeared. However, some bilateral trading agreements continue to exist in nearly all of the nine selected countries.[85]

Quantitative Export Controls

Mexico has tied its quantitative export control policy closely to its export tariff policy.[86] Furthermore, it has tied its quantitative

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82 This observation is based on spot counts of commercial policy changes reported in various issues of the Foreign Commerce Weekly from 1950 to 1960.

83 See IMF, Eighth Annual Report on Exchange Restrictions, 1957, p. 334, and subsequent issues.

84 IMF, Second Annual Report on Exchange Restrictions, 1951, pp. 107 and 125.

85 See the various country summaries in the IMF, Eleventh Annual Report on Exchange Restrictions, 1960.

86 See above, p. 142.

export control policy closely to its import control policy by administration (the Ministry of Economy) and objectives.[87] The common objectives of all of these foreign trade control instruments are (1) assured domestic supplies of foodstuffs, raw materials, and other essentials, and (2) encouragement of domestic processing and manufacture, both for internal consumption and manufacture.[88] Some commodities are prohibited exportation and others require an export permit.[89]

As these policies are successful, production and exports will be diversified. Some degree of success is indicated by the fact that between 1953 and 1958 the fifteen most important export commodities by value dropped from 61.7 percent of the total value of exports, to 53.8 percent.[90]

India, Pakistan and the Philippines have established quantitative controls on exports with similar purposes and patterns (allowing for individual country variation) to those of Mexico.[91] The combined effects of their commercial policies and internal development policies on industrial origin of domestic product indicate some success in achieving diversification, although export patterns have not changed significantly as yet. In India, manufacturing as a percent of net domestic product increased between 1953 and 1957 from 15.9 to 17.2 percent. The same

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87 WTIS, "Licensing and Exchange Controls...Mexico", Operations Reports, Part 2, No. 58-50, p.3.

88 Ibid.

89 For a partial list of commodities affected, see Ibid.

90 WTIS, "Economic Developments in Mexico", Economic Reports, 1954 and 1958, Part 1, Nos. 55-60, Table 6, p. 14, and 59-36, Table 5, p. 12. For changes in domestic production, see above, p. 147.

91 WTIS, Operations Reports, Part 2, Nos. 58-58 (India), p. 3, 59-77 (Pakistan), p.3, and 58-10 (the Philippines), p. 5.

change in Pakistan between 1953 and 1958 was from 8.9 to 12.1 percent, and in the Philippines, from 11.9 to 16.0 percent.[92]

EXCHANGE CONTROL EXPERIENCE

As pointed out previously, Mexico is the only one of the selected countries that maintains an entirely free market for foreign exchange. Although Peru officially has an exchange control system, in practice international payments are made virtually without restrictions. The exchange control systems of India, Pakistan and the Philippines are relatively stricter than other systems because control decisions are effected by rationing exchange, but this characteristic reduces to insignificance the currency exchange rate features of exchange control.[93]

Thus, the evaluation of experience with exchange controls is limited primarily to those exchange control systems that have utilized mainly costs (i.e., exchange rate) influences on trade and payments conditions, or a composite of cost and quantitative control features.[94] Brazil, Chile, Colombia and Ecuador have maintained such exchange controls, at times developing extremely complex systems, but all except Brazil have made significant changes in the direction of greater simplicity in recent years.

All four of these exchange control systems have been characterized by numerous effective multiple exchange rates combined with import

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92 ECAFE, Economic Survey, 1958, Table N, p. 177, and 1959, Table 6, p. 113.

93 See above, pp. 144f.

94 For these distinctions see, IMF, First Annual Report on Exchange Restrictions, 1950, pp. 4ff.

licensing requirements and import prohibitions. The exchange control policies have all established priorities of imports and exports based on essentiality and protection of internal producers.[95]

Disadvantages of Complex Exchange Controls

Chile. The exchange control system of Chile was, until 1956, the most complex of the selected-country systems. Its complexity stemmed from lumping together, in one system at the same time, virtually every exchange control technique and basis of discrimination possible.[96]

In this Chilean exchange control system, some imports were prohibited; all non-prohibited imports required individual import licenses under quotas; and some specified imports were permitted only through two different "free markets" supplied by earnings from exports of gold and wine. Export licenses were required for all exports, and exchange licenses for most non-trade payments.

The fixed buying rates, one of which was the "official" rate were established for the foreign exchange proceeds from various specified exports and invisibles. There were also "mixed" buying rates that combine five percentage mixes of the "official" and one other fixed rate. The mixed rates were applicable to the exchange earnings from certain specified exports. At times, some "mixes" involved percentages of a "free market" fluctuating rate, and therefore fluctuated also.

A similarly complex rate structure was applied to the foreign

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95 Ibid., p. 92, et. passim.

96 For full details see IMF, Annual Reports on Exchange Restrictions, 1950 through 1956.

exchange selling rates for imports and specified in similar detail. Some of the exchange rate differentials were based on different treatment of large foreign-owned mining companies as opposed to small mining firms. Furthermore, the exchange control system included discriminatory treatment of the various currencies used in international transactions, and rates for all currencies were stated in the above fashion. There were, therefore, broken cross rates throughout the entire rate structure. In the "Table of Exchange Rates" for December 31, 1952,[97] there were twelve buying rates--six fixed rates (one of which was mixed) and six fluctuating rates (two of which were mixed), and eight selling rates--four fixed and four fluctuating.

Thus Chile's exchange control system has discriminated on the basis of importers, exporters, currencies, and products. The structure of the system and the policy decisions made in administering it have been designed to raise revenue, protect internal producers, protect the balance of international payments, and control the pattern of imports and exports. Finally, changes in the system have been frequent and involved.[98]

This strict program of foreign exchange controls was accompanied by similarly widespread controls in the domestic economy. Together, these policies had particularly adverse and disincentive effects on agriculture and mining. Restrictions of exports tended to retard agricultural development during the first half of the 1950's and turned

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97 IMF, Fourth Annual Report on Exchange Restrictions, 1953, p. 98f.
98 WTIS, "Licensing and Exchange Controls...Chile", Operations Reports, Part 2, No. 55-93, pp. 1-2.

Chile from near self-sufficiency in basic foodstuffs in the prewar period (10 percent of total imports, 1935-39) to a heavy importer of foodstuffs in the early 1950's (29.3 percent of total imports, 1953-56).[99] The "great mining" industry, especially copper and nitrates, has historically provided the bulk of Chile's exports. Discriminatory price and sales controls, taxation, and exchange rates retarded Chilean mining development to such an extent that the world turned to synthetic nitrates and Rhodesian copper.[100]

The effects of these detailed developments on the general economic development of Chile are evident in Chile's ranking at the bottom of the selected countries in percentage increase in national income and percentage change in per capita product (an actual decline of three percent) over the period 1950-57.[101] Chile also experienced a 3.4 percent rise in the ratio of consumer goods imports to total imports from 1953-56, and a decline of 1.6 percent in its ratio of raw materials imports to total imports over the same period.[102]

The revision of the exchange control system in Chile on April 20, 1956, abolished import licensing and substituted an extensive list of authorized imports with a requirement of advance deposits graduated on the basis of essentiality and availability of domestic supply.[103] Since April, 1959, the advance deposits have been applied to seven categories

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99 WTIS, "Basic Data on the Economy of Chile", Economic Reports, Part 1, No. 59-15, p. 5.
100 Ibid., p.8.
101 See above, Table 1, p. 124
102 See above, Table 5, p. 138.
103 IMF, Seventh Annual Report on Exchange Restriction, 1956, p. 71.

with rates from five percent of value to 1500 percent of value, the latter rate being applied to items not on the authorized list of imports. The 1956 revision also abolished the system of multiple exchange rates, and established two freely fluctuating rates, one for trade and the other for capital transactions and invisibles. These dual rates have been unified into a single exchange rate for all import and export transactions.[104]

The immediate effect of the 1956 revision was a rapid deterioration in the balance of payments which continued through 1957, into 1958, under pressure of declining world prices of copper. During May, 1958, advance deposits for imports were set at 10,000 percent of c.i.f. value, and then lowered to a high of 5,000 percent on June 5. By January, 1959, the depreciation in the value of the peso, that had been continuing since the revision of exchange controls in 1956, was beginning to take effect to slow the rise in imports and increase exports. The Central Bank entered the exchange market to stabilize the peso when the single exchange rate was established in April, 1959.[105]

Several historical factors in the Chilean economic background have contributed to the apparent success of her movement toward freedom of international trading relations.[106] Historically, Chile has had an

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104 WTIS, Operations Reports, Part 2, No. 60-8, pp. 1-2, and Economic Reports, Part 1, No. 59-43, p. 7.

105 Ibid.

106 While Chile's tariffs and advance deposits on imports still influence the pattern of imports toward consumption and development essentials and away from luxuries, the government has indicated its intention to remove the advance deposits eventually. In addition, some export quotas are still in force on some foodstuffs, agricultural raw materials, and on iron ore to assure adequate domestic supplies. Ibid.

export balance of trade;[107] it began to institute governmental economic development policies as early as 1927;[108] and it had attained the highest level of economic development (per capita income) of the nine selected countries by the beginning of the decade under study.[109] With these factors, and all that they imply for greater ease of development, working in her favor, Chile should be able to stimulate development more successfully than less developed countries with less strenuous control measures.

Brazil, Colombia, and Ecuador. Brazilian experience with exchange controls during 1949-59 divides into two periods, before October, 1953 and after. Exchange controls in the earlier period were exercised through import and export licensing in accordance with a foreign exchange budget of the export proceeds which had to be surrendered, and multiple exchange rates for imports and exports. The multiple import rates resulted from an exchange tax, and the multiple export rates from a requirement of a percentage investment of export proceeds in negotiable treasury bills.[110] One of the primary difficulties with this system was that import licenses were issued on criteria other than exchange availability, and the exchange authorities in allocating foreign exchange for licensed imports accumulated a large backlog of pending payments.[111]

In October, 1953, Brazil established an exchange auction system for imports, with minimum auction bids differing by import priority

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107 WTIS, Economic Reports, Part 1, No. 59-15, p. 16.
108 Wythe, op. cit., p. 71.
109 See above, Table 2, p. 126.
110 IMF, First Annual Report on Exchange Restrictions, 1950, p. 92f.
111 IMF, Fourth Annual Report on Exchange Restrictions, 1953, p. 81.

categories.[112] A system of differential export bonus rates were established to encourage minor exports.[113]

While this Brazilian auction system appears in some respects, especially the number of effective exchange rates, to be as complex as the Chilean exchange system,[114] it has certain advantages. The Chilean system involved detailed allocation of exchange among individual import items, while the Brazilian exchange auction system allocated exchange to auction markets for broad categories of imports, with the allocation of exchange to individual import items within the broad categories on a price basis. The result was a less arbitrary and more orderly system for private trading.

Furthermore, it appears that Brazil's effective control over the pattern of imports in favor of development may have improved with the auction system. Brazil's ratio of raw materials imports to total imports increased over the period 1953-56. The corresponding ratio for consumer goods imports increased only slightly, and the ratio for capital goods imports declined sharply.[115] The decline in the ratio of capital goods imports may be partially explained by increased domestic production of machinery and equipment.[116]

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112 See above, pp. 134f.

113 IMF, Fifth Annual Report on Exchange Restrictions, 1954, p. 65. For an excellent detailed analysis of the operation of this system, see A. Kafka, "The Brazilian Exchange Auction System", Review of Economics and Statistics, Vol. 38, Aug. 1956, pp. 308ff.

114 References to the Chilean exchange control system refer to the system prior to April, 1956.

115 See above, Table 5, p. 137.

116 ECLA, Economic Bulletin, III, 2(October, 1958), Table 9, p. 48.

The exchange control system of Colombia has been basically similar to the earlier Brazilian system. Its multiple exchange rates resulted from discriminatory exchange taxes on imports and permission for proceeds from favored exports to be sold in an exchange certificate market rather than surrendered at the official buying rate. A special feature that protected the balance of payments was the granting of exchange licenses for imports each week only to the limit of the gold and foreign exchange purchases of the Central Bank during the preceding week.[117]

Colombia, relative to the other selected countries, achieved notable success, up to 1956, in controlling the pattern of imports for development with this exchange control system.[118] Since late in 1956, Colombia has progressively tightened import restrictions in response to large balance of payments deficits in 1955 and 1956. Balance of payments surpluses were achieved in 1957 and 1958, but at the expense of sharp reductions in the value of imports and total trade. These developments have occurred under pressure of declining export earnings due to a decline of world prices for coffee since 1957.[119]

Of the four subject countries emphasizing exchange controls, Ecuador has incorporated the fewest quantitative control aspects in its system. All imports require licenses, but most imports have been licensed freely.[120]

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117 IMF, First Annual Report on Exchange Restrictions, 1950, pp. 99 ff.

118 See above, Table 5, p. 137.

119 WTIS, Operations Reports, Part 2, No. 58-46, p. 1, and 59-25, p. 1; U.N. Statistical Yearbook, 1958, Table 166, p. 460; and ECLA, Economic Bulletin, III, 2(October, 1958), Table 16, p. 56.

120 IMF, First Annual Report on Exchange Restrictions, 1950, p. 108f.

The influence on the pattern of imports by essentiality and domestic producer protection priorities was earlier obtained by graduated exchange surcharges, and more recently by different advance deposits for imports in two lists. Ecuador has had essentially dual exchange rates (official and free market) for both imports and exports since about 1952. List one imports are favored and enter at the official rate. All other authorized imports enter through the free market at the less favorable rate. There are a few mixed buying rates applied to important, but not "major", exports, most minor or marginal exports receiving the bonus rate of the free market with major exports obtaining the lower official rate.[121]

Ecuador has had moderate success, relative to the other selected countries, in controlling the pattern of its imports.[122]

Mobilizing Foreign Exchange for Development

The fact that all of the exchange control systems of the selected countries were instituted in periods of balance of payments difficulties[123] indicates the importance of the relationship between adequate foreign exchange availabilities and satisfactory operation of the domestic economy in underdeveloped countries. The fact that they have all established import priorities in their exchange control systems indicates the close relationship between the relative adequacy of foreign exchange availabilities and the need for its careful allocation to meet development needs.

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121 Ibid., and IMF, Tenth Annual Report on Exchange Restrictions, 1959, p. 109.

122 See above, Table 5, p. 137.

123 See above, p. 145.

All of the exchange control systems have been designed to mobilize foreign exchange to meet current consumption and development needs. As a necessary first step in mobilizing foreign exchange, all of the exchange control countries, including Peru, require proceeds from exports to be turned over to official agencies or authorized dealers. The two parts of the exchange mobilization problem as reflected in the control practices of these countries, are (1) increasing foreign exchange availabilities and (2) allocating foreign exchange to the most pressing consumption and development needs.

Exchange Control Practices to Increase Foreign Exchange Availabilities

Practices to Increase Net Foreign Exchange Earnings. All four of the composite exchange control countries have at some time utilized indirect export subsidies in the form of more favorable buying rates for some exports. The practice has been to apply the most favorable rate to minor exports and the lowest rate (usually the official rate) to the one or two major export commodities which dominate the country's exports. There is little indication in the statistics for any of these countries that such bonuses have had significantly successful effects.

Another major source of foreign exchange receipts is in the form of investments from abroad. Practices in control of capital movements have been marked by similarities in the exchange control countries. Typically capital is permitted to enter and leave freely through the "free" market, i.e., at the highest exchange rate. In approved cases capital may enter at the official (lowest rate), but must be registered and foreign exchange proceeds must be surrendered. Approved or register-

ed investments are ordinarily permitted repatriation and transfer of earnings at the exchange rate at which the capital entered.

Investments abroad by residents are usually permitted at the free market rate of exchange, but are subject to prior approval. In contrast, India, Pakistan, and the Philippines have not usually permitted resident investment abroad, and have restricted transfer of invisibles.

Little can be accomplished in inducing foreign investment by manipulation of exchange rates. The exchange control countries give evidence by their treatment of capital transfers of acceptance of that principle. Investment requires investment opportunities, and a consistent policy of promoting development, with due consideration for preventing excessive inflation, can do most to provide investment opportunities. The trend of direct foreign investments in the selected Latin American countries and the Philippines from 1950 to 1958 has been upward, while the experience of India and Pakistan has been more variable.[124]

Allocation of Foreign Exchange. The principal devices which the composite exchange control countries have used to allocate foreign exchange have been the exchange auction system of Brazil, differential exchange taxes, and advance deposits for imports.[125] All of these systems, including advance deposits when interest on money is considered, involve different effective exchange rates applied to imports. For this purpose priorities of imports are established. The experience of Brazil, Colombia and Ecuador, as opposed to that of Chile (pre-1956), demonstrates that exchange controls over the pattern of imports operates

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124 IMF, International Financial Statistics, 1959.
125 See above, pp. 156ff.

more effectively when the priorities are established only in terms of a few broad categories of imports.[126]

In some cases the multiple exchange rates have been supplemented by import prohibition, e.g. Ecuador,[127] and in all four countries by import licensing. Exchange licenses for most trade and invisibles transactions have been used to enforce the mechanics of the systems. Brazil (in 1953) and Colombia (in 1957) discovered that some direct tie between the issue of import licenses and exchange licenses is necessary, in lieu of an exchange budget, in order to avoid a backlog of commercial payments and make the controls effective.[128]

The relative effectiveness of exchange controls for controlling the pattern of imports was evaluated above.[129] It may be noted that the development achievements of Brazil, Ecuador and Colombia, in terms of percentage increase in per capita product, was moderate relative to the other selected countries.[130] The poor showing of Chile was noted earlier.

SUMMARY

The experience of the selected countries during the decade, 1949-1959, tends to bear out the broad conclusions of the theoretical analysis of the preceding chapter.

Economic development, as the primary national objective in Brazil,

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126 See above, pp. 156ff.
127 IMF, First Report on Exchange Restrictions, 1950, p. 108.
128 See above, 160ff.
129 See pp. 156ff.
130 See above, Table 1, p. 124.

Chile, Colombia, Ecuador, India, Mexico, Pakistan, Peru and the Philippines, emerged in the post-World War II period. The earlier utilization of commercial policy instruments to assist economic development in the decade under study was often marked by complexity of control systems and lack of coordination. In all nine selected countries the tendency toward the end of the decade has been to simplify the control systems and integrate the commercial policy instruments used. In these tendencies there is an indication of movement toward functional specialization in the use of the broad types of commercial policy instruments.

Toward the end of the decade, all of the selected countries still relied on import and/or export tariffs to obtain significant percentages of their total governmental revenues. Brazil, Chile and the Philippines had moved in this direction away from relatively greater reliance on exchange taxes or profits earlier in the decade. In all of these tariff systems, ad valorem rates predominated over specific duties, resulting in greater compensatory effects in relation to price fluctuations.

In each case, the tariff rate structure has combined some control over the pattern of imports and exports and protection of domestic producers with the revenue objectives. The rates have been graduated by import and export priorities based on (1) essentiality to the domestic economy and (2) sufficiency of domestic supply.

Except in the case of Mexico, little use has been made of tariff rate manipulations to combat balance of payments deficits. Even Mexico has relied primarily on devaluation during payments crises to protect its balance of payments and discourage capital flights. It has supplemented devaluation increasingly by quantitative import restrictions

rather than tariff manipulations.

Direct foreign trade subsidies have been used by the selected countries only to a limited extent. The principal form of import and export subsidization has been indirect through differential exchange rates in the exchange control system of Brazil, Chile, Colombia and Ecuador.

With the exception of Peru, all of the selected countries have relied primarily upon quantitative trade controls or exchange controls to protect their balance of payments, to protect domestic producers and to control the pattern of their foreign trade. There has been no significant attempt to incorporate revenue collection with quantitative controls through variable license fees. Instead, graduated customs surcharges or internal sales taxes have been levied on imported commodities according to the degree of restrictiveness of quantitative controls in order to capture the windfall profits that would otherwise accrue to importers.

The quantitative and exchange control systems of the selected countries were all instituted during periods of balance of payments deficits. Yet removal of balance of payments deficits has been the dominant objective of these control systems only during payments crises. Increasingly, the primary objective has been to insure that scarce foreign exchange be used for the importation of essentials, i.e., control over the pattern of foreign trade.

In controlling the pattern of imports and exports, both the quantitative and exchange control systems have been designed to increase the supplies of capital goods, raw materials and essential consumer goods in the domestic economy and to encourage domestic production of such goods.

Changes in the pattern of imports of all of the selected countries during the decade indicate that those countries emphasizing quantitative controls, i.e., Mexico, India, Pakistan and the Philippines, have achieved the most notable success in controlling the pattern of trade to promote economic development.

All of the selected countries, except Mexico, have combined quantitative and exchange controls. Those countries emphasizing quantitative aspects of control in such joint systems (India, Pakistan and the Philippines) have proved more successful in mobilizing the available foreign exchange for development use. The weakness of exchange control systems which emphasize price and cost direction of trade by means of multiple exchange rates stems from the difficulty of implementing a foreign exchange budget. The experience of Brazil and Colombia in accumulating large payments backlogs illustrates this difficulty.

In efforts to eliminate payments backlogs, Brazil and Colombia found it necessary to substitute some direct tie between import and exchange licenses in lieu of an overall exchange budget. However, the experience of these two countries in comparison with that of Chile illustrates the need for allocating foreign exchange to various payments requirements in terms of broad categories of imports and invisibles payments rather than in terms of detailed specification.

The poor development performance of Chile indicates that extremely complex and detailed exchange controls disrupt the development process rather than assisting it.

CHAPTER VI

CONCLUSION

THE PLACE OF COMMERCIAL POLICIES IN DEVELOPMENT PROGRAMS

For economically underdeveloped countries, obstacles to development are social and political in nature, as well as economic.[1] In the economic sphere, developmental deficiencies are so varied and pervasive of the entire economy that economic development requires coordinated programs emphasizing domestic monetary, fiscal and promotional policies.[2] Hence, commercial policy, i.e., regulation of foreign trade and payments relations, can only hold a supplemental position in economic development programs of underdeveloped countries.

The problem for this study thus was one of determining the effectiveness and the effects of commercial policy as a supplement to more general economic development programs of underdeveloped countries. The commercial policy instruments selected for study were (1) tariffs and foreign trade subsidies, (2) quantitative controls and (3) exchange controls.[3] This selection excludes state trading, bilateral trade and payments agreements, and international cartels and commodity agreements.[4]

Commercial policy is essentially only supplemental to domestic economic development programs, yet it has a unique significance for stimulating development in underdeveloped countries. This unique signifi-

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1 See above, pp. 5ff.

2 Ibid. See, also, the discussion of free trade policy versus development in underdeveloped countries, Chap. II.

3 See above, pp. 43ff.

4 For the reasons for these exclusions see above, pp. 44f.

cance stems from the fact that so much of the market exchange activity in underdeveloped countries is centered in or closely related to the international trade sector of their economies.[5] Thus commercial policy is applicable to that sector where a start on development has been made, yet where the market mechanism does not always guide private economic activity toward internal economic development.[6] Commercial policy instruments are applied at that point where the broad development objectives, i.e., (1) improvement in the quality of human effort, (2) accumulation of capital, (3) structural change in the economy, involving reallocation of existing resources and change in the pattern of resources, (4) expansion of the exchange economy, and (5) improved technology, relate to foreign markets.[7]

PROCEDURE OF INVESTIGATIONS

The investigation was carried out under the following assumptions: (1) That the predominant economic objective in underdeveloped countries is economic development in the form of a sustained increase in real national income per capita, (2) that the economic objective of most efficient allocation of resources must be oriented around structural change in the form of changes in the quality and quantity of resources such that the productivity of human efforts is raised, (3) that domestic markets are inadequate in refinement and extent for efficient allocation of resources, especially as between production for present consumption

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5 See above, p. 60.
6 See above, pp. 28ff.
7 See above, pp. 60ff.

and for capital formation, (4) that the usual givens of economic analysis, i.e., technology, productive functions and the pattern of resources, are susceptible to deliberate modification in a relatively short period of time, say a generation, and (5) that governments in underdeveloped countries will have to assume an active role in the economy to initiate production and stimulate private enterprises if economic development is to occur as rapidly as internal and world political conditions require. The evaluation of the applicability of traditional international trade theory to underdeveloped countries in Chapter II constitutes a justification of adoption of these assumptions.

The emphasis of the study has been on (1) the potentialities of coordinating commercial policies in pursuit of economic development and on (2) the relative effectiveness of the particular commercial policy devices--tariffs and foreign trade subsidies, quantitative controls, and exchange controls--in furthering the various development objectives. Almost anything that can be done with one broad category of commercial policy instruments can also be accomplished, more or less effectively, with some variant of either of the other broad categories, yet differences in the nature of the commercial policy instruments in regard to price and quantity effects make each more appropriate for certain functions than each of the others.[8] The question posed for answer in the theoretical analysis of Chapter IV was: Which commercial policy variants are most appropriate for fulfilling which commercial policy objectives that are in turn selected for their contribution to fulfillment

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8 See above, pp. 45ff.

of development objectives and needs?

From the theoretical analysis of Chapter IV, it was concluded that functional specialization in the use of the broad types of commercial policy instruments can make possible a simpler structure in each instrumental system, resulting in fewer internal contradictions in each system and more efficient promotion of the limited objectives of each. The bases for distinguishing different appropriate functions for tariffs and foreign trade subsidies, quantitative controls, and exchange controls were primarily their differences in impact points, certainty of various price and quantity effects, and flexibility of administration.

The theoretical analysis suggested that tariffs should be reserved primarily for raising government revenue with assistance for controlling the pattern of trade and for protection of internal producers built into the system only as such assistance to other objectives is consistent with the main revenue purpose.[9] Quantitative controls should be reserved primarily for protection, both of internal producers and of the balance of payments in emergencies, including the control over the pattern of trade which protection involves.[10] Exchange controls should be used primarily for increasing the availability of foreign exchange and for allocation of foreign exchange for development.[11]

The theoretical analysis of Chapter IV was subjected to empirical examination in Chapter V against the commercial policy experiences of Brazil, Chile, Colombia, Ecuador, India, Mexico, Pakistan, Peru and

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9 See above, pp. 73ff.
10 See above, pp. 97ff.
11 See above, pp. 99ff.

the Philippines during the decade 1949-1959. The primary reason for selecting these nine underdeveloped countries[12] was their diversity in the commercial policy instruments utilized.[13]

The experience of all nine countries was analyzed in regard to tariffs for revenue. The analysis of tariff utilization for other objectives dealt primarily with Peru and Mexico. India, Pakistan and the Philippines have utilized primarily quantitative control in conjunction with exchange budgeting. Mexico has emphasized quantitative controls, and is the only one of the selected countries that has had no exchange controls during the decade under study. The analysis of exchange control experience concentrated on Chile and Brazil, but included Colombia and Ecuador.

For information on the commercial policy systems and manipulations, main reliance has been placed on the U. S. Department of Commerce, World Trade Information Service, Operations Reports on tariff, quantity licensing and exchange control systems, the Foreign Commerce Weekly reports of trade control changes, and the International Monetary Fund, Annual Reports on exchange restrictions. For economic developments and statistical data to analyze the effects of the commercial policies, primary sources have been the United Nations, Statistical Yearbook, the Economic Bulletins of the Economic Commissions for Latin America and for Asia and the Far East, and the WTIS, Economic Reports of basic data on the economies of the selected countries and of economic developments in those

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12 All had per capita national incomes of less than $200 in 1949. See Table 2, p. 126.

13 For other considerations in selection, see p. 120.

countries.

The effects of commercial policy actions of the selected countries have been anlyzed in terms of changes in the composition of imports and exports, government revenues by sources, industrial origin of production, gold and foreign exchange balances, balances of payments, real- and money-capital movements, terms of trade, and in the aggregates of total national income and national income or product per capita, quantity and value of imports and exports, and foreign and domestic investment.

SOME CONCLUSIONS

Only two of the selected countries have failed to increase per capita product (1950-56 or '57) at a rate of two per cent or better.[14] Of the two countries that experienced actual declines in per capita product, Pakistan started from an extremely low level and suffered from disasterous floods[15] and a 73 percent decline in its terms of trade.[16] Chile imposed a complex, inconsistent and erratic system of exchange controls.[17]

The most significant contributions that commercial policies have made in assisting the processof economic development in the selected countries have been to raise government revenues, to change the pattern of foreign trade in the direction of capital accumulation and away from unnecessary consumption, and to encourage diversification in domestic production. In addition, there has been a tendency toward coordination

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14 See above, pp. 122f.
15 See above, pp. 126ff.
16 See fn. 7. p. 123.
17 See above, pp. 156ff.

of the use of commercial policy instruments with greater specialization of function for the different instrumental systems.

Each of the selected countries has used tariffs or exchange control profits to raise significant proportions of total government revenues. Tariffs have predominated for this purpose, and Brazil, Chile and the Philippines, which earlier relied heavily on revenue from exchange controls, have moved toward greater reliance on tariff revenues since 1956.[18]

Each of the selected countries has used a combination of differential tariffs with quantitative controls and/or exchange controls to change the pattern of foreign trade. The analysis of changes in the pattern of imports indicated that those countries emphasizing quantitative controls (except Pakistan) have proved most successful in influencing importation in the direction of capital goods or raw materials in support of increased production levels. In addition to Pakistan, Chile and Peru have been least successful in exercising such influence on the pattern of import.[19] The difficulties of Pakistan and Chile were indicated earlier in this section, while Peru most nearly approaches a free trade policy.

With its combination of quantitative controls on both imports and exports, Mexico has demonstrated the greatest success in diversifying domestic production, as well as exports.[20] There are indications of some diversification in changes in the industrial origin of domestic

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18 See above, pp. 130ff.
19 See Table 5, p. 137.
20 See above, p. 154.

production in India, Pakistan and the Philippines.[21]

The evidence of commercial policy effects on inflationary forces and on the terms of trade was too meager to draw any reliable conclusions.

The prospects of continued utilization of commercial policies to promote economic development vary from country to country on the basis of a number of differences in their economic conditions. The level of development already achieved is of particular significance. India, Pakistan and the Philippines, at the bottom of the per capita income scale in 1953,[22] have closely integrated the three instruments of commercial policy as a part of economic development programs. The need by these three countries for such concerted promotion of economic development is likely to continue indefinitely.

Chile, at the top of the per capita income scale in 1953 and with a bad experience in the use of exchange controls, has moved toward abandonment of all controls except tariffs and differential advance deposits for imports.[23] As some economic progress has been achieved in the other countries, the tendency has been to relax the restrictiveness of the commercial policy instruments used, or to move toward retention of tariffs only.

Progress in abandoning commercial policies will likely depend on achievement of a stable world economy. When balance of payments crises arise, the tendency is to tighten controls on foreign trade and

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21 See above, pp. 154f.
22 See Table 4, p. 132.
23 See above, pp. 157ff.

payments,[24] and balance of payments crises of underdeveloped countries are commonly associated with economic fluctuations in the advanced countries.[25]

There has been no apparent adverse effect of commercial policies in underdeveloped countries on the level of world trade. While it is impossible to say what that level would have been without commercial policy practices in underdeveloped countries during the decade under study, the volume of trade of each of the selected countries, except Pakistan, has been observed to have increased. Declines in the trade levels of underdeveloped countries have usually been associated, although in a lagged relationship, with fluctuations in developed-country demand for underdeveloped country exports, rather than deliberately initiated by trade restrictions.[26]

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24 See, for example, Colombia's experience, p. 162.
25 See above, p. 80.
26 See above, pp. 124f.

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